

# **CORRUPTION IN PUBLIC PROCUREMENT**

## **RISKS AND REFORM POLICIES**

Konstantin Pashev  
Assen Dyulgerov  
Georgi Kaschiev

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5 Alexander Zhendov Str. 1113 Sofia  
phone: (+359 2) 971 3000  
fax: (+359 2) 971 2233  
www.csd.bg  
csd@online.bg

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## INTRODUCTION

Public procurement is among those spheres in the management of the public sector in Bulgaria which are characterized by the highest corruption risk. Generally speaking, the abuses in this sphere relate to the awarding of a public procurement contract to a pre-selected supplier **to the detriment of the public interest through violation of the principles of competition for the purpose of gaining personal benefit.**

Corruption in public procurement can hardly be put into the neat subdivisions of the conventional dichotomy of big and small corruption. The public sector purchases goods and services at all levels in various volumes and at different value of the supplies, starting from paper clips and other office materials to infrastructure projects. The favoritism with regard to a specific supplier, which is harmful to the public interest, can be observed anywhere from the smallest day-to-day supplies to the biggest tendering procedures directly supervised and controlled by senior government officials. The personal benefit can take the form of cash, power, jobs in the private or public sector, etc.

This study focuses on large-scale corruption in the public procurement field with the goal to fine-tune the policy tools used to minimize the level of corruption. This type of corruption covers all transactions and procedures which fall or should fall within the scope of the public procurement legislation. These are most of the supplies the price or qualitative parameters of which are subject to **negotiation** between the contracting authorities in the public sector and the suppliers from the private sector. Exceptions to this rule are the supplies of consumables, materials or services which are only occasional and cannot possibly be subject to budget planning in parameters that would make it possible to conclude framework agreements for larger volumes. Such consumption of goods and services in the public sector, which cannot be planned and aggregated for the purpose of economic benefit, should be rather limited. It is below the thresholds prescribed by the law for holding public procurement procedures. However, when this direct off-the-shelf consumption is to intentionally circumvent the legislation, even small-scale purchases (below the statutory thresholds which require transparent procedures) could provide personal benefit to the lower levels of the administration in this particular case.

Despite the existence of corruption risk at all levels of government, this paper is interested in the abuse in public procurement mainly as **the objective and tool of large-scale corruption.** Two aspects of the problem can be identified. The first is **the economic** one. It is related to the economic and fiscal cost of the abuse,

as well as to the respective institutional prerequisites and barriers in the system applied to the management of public spending. In this context, the emphasis is placed on the losses sustained by society from the negotiated supply of goods and services to the public sector under terms and conditions which are **worse than the market ones**, i.e. either at higher prices than the market levels or of inferior quality. This is a case of inefficient use of public funds, where decision-makers receive undue personal benefit. In brief, this is the most logical question that any taxpayer would ask him/herself in order to assess the actions of those who manage public resources. If they were buying the respective good or service for themselves, would they accept the same terms and conditions? This question synthesizes the logic of the **economic efficiency** criteria in public procurement. It comes down to the **principles of expediency** in the control and counteraction of corruption in this sphere.

The second aspect of the problem is a **legal** one. It is related to the issue of what regulatory barriers could stop such actions and make them illegal and to what extent they are applied effectively. The emphasis here is on the statutory checks and balances and the application of the **principles of legality**. However, one cannot always seek the administrative responsibility or penal liability of decision-makers for purchasing under unfavourable terms and conditions. In many cases they harm public interests without breaking the law. Such examples can be seen at all levels of contracting - from the purchase of office materials to the purchase of nuclear reactors. **This has recently become the reason for the emphasis to shift from the efforts aimed exclusively at improvement of the legal framework to control over the expediency of the actions of budget spending units.** The big challenge here is that legality is established in adversarial court proceedings according to clear-cut codified rules, while expediency is a more amorphous category with less clearly defined rules and therefore it is more exposed to the threat of administrative discretion.

This study is intended to build **a bridge between the economic and legal levers** to counteract corruption in public procurement. Regardless of whether there is a violation of the existing regulations, the contracting authority **has restricted competition in one way or another**, which has harmed the public interest in terms of the price and quality of the respective public services or goods. Precisely this opportunity for suppliers to compete in public procurement serves as the point of departure for the review of the legal framework in this sphere in Bulgaria. It is also the main criterion applied to the assessment of the corruption risk and the relevant anti-corruption measures.

In this context, the task to bring together the economic and legal tools in combating corruption in public procurement can be expressed as an answer to the following question: **if the objective is to ensure as much free and fair competition as possible in public procurement, what is the institutional and regulatory framework for its attainment, which is optimal from the economic perspective?**

The goal of the analysis is, first and foremost, to identify the normative and institutional prerequisites for the most common corrupt practices in public procurement and to suggest anti-corruption measures. Furthermore, it expands

the conventional approach in two aspects. First, it emphasizes the economic assessment of the effect of regulations and, second, it directs risk assessment and control to use objective expediency criteria. Chapter 1 outlines corruption in the public procurement as a main driving force and tool of political corruption. Chapter 2 presents the most common corrupt practices and abuses in Bulgaria and tries to give an approximate estimate of the magnitude of the phenomenon and the damage it causes. Chapter 3 focuses on the sectoral dimension of the problem based on the example of a sector with one of the highest corruption risks, i.e. energy. Chapter 4 connects the economic and legal aspects of the prevention of corruption and financial abuse in the public procurement sector. It contains a critical analysis of the way in which the anti-corruption policy and institutions have faced these challenges so far. The chapter traces out and reviews the structural reforms in the public procurement sphere in the light of the EU accession process, the changes in the Bulgarian legislation and administrative practices, as well as the control over the implementation of contracts. The conclusion summarizes the main findings and suggestions with regard to the anti-corruption policy.

The authors of the individual sections are as follows: Chapters 1 and 2 – Konstantin Pashev; Chapter 3 – Assen Dyulgerov and Georgi Kaschiev; Chapter 4 – Konstantin Pashev and Assen Dyulgerov.<sup>1</sup> Vesela Georgieva from the Center for the Study of Democracy has rendered valuable technical assistance.

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<sup>1</sup> Konstantin Pashev is a PhD holder in Economics, Associate Professor in the Economics of the Public Sector, and Senior Economist at the Center for the Study of Democracy; Assen Dyulgerov is a practicing lawyer; Georgi Kaschiev is a PhD holder in reactor physics, lecturer and researcher at the Institute for Risk Research of the University of Vienna.





# 1. PUBLIC PROCUREMENT: A DRIVING FORCE AND INSTRUMENT OF POLITICAL CORRUPTION

## 1.1. POLITICAL ECONOMY OF CORRUPTION IN PUBLIC PROCUREMENT

As varied as they are, abuses in the area of public procurement aim at re-directing financial resources from public spending units and state-owned or municipal enterprises to the private benefit of individuals who are responsible for procurement decisions. Corruption in public procurement could be seen through two supplementing economic models. The first one is the **principal-agent model**. It explains **the opportunities** for gaining private benefit by disposing of taxpayers' money. Budget spending management in modern democratic systems implies the **delegation of rights and responsibilities** from the citizens (the principal) to the elected politicians (the agent) and even to deeper levels of the political structure. Here the mandate is not fully specified. Decision-makers have some discretionary powers because voters cannot predict all the decisions of politicians and senior officials concerning public spending in the election process. Voters can only demand from them to keep up with their programs and promises and to hold them accountable based on the results.

This mandate is not only incomplete; it is also very heterogeneous. It is a projection of the choice made by the general public, striking a balance between different social interests and views on public spending. In short, **the incompleteness and heterogeneity** of the mandate are incentives for the mandate holder (the agent) to deviate from it.

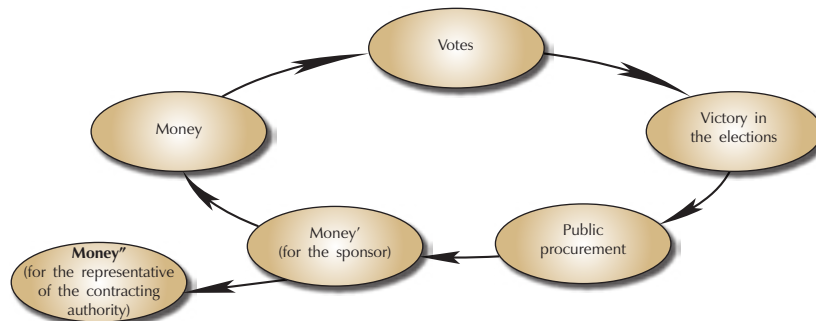
Within the framework of this conceptual construct, the measures to counteract abuses in the management of budget spending are primarily related to making the mandate more specific, i.e. providing the details with regard to the responsibilities of contracting authorities in the public procurement process and reducing the scope of administrative discretionary powers in the contract awarding process. The tendency to ensure detailed and comprehensive regulation of these procedures and the emphasis laid on lawfulness in the control phase have been the manifestations of this logic so far. But the mandate can be made more specific also by clearer definition of the objectives to be attained. This is the rationale underlying **the increased relative share of expediency criteria** at the expense of the narrower lawfulness criteria prevailing so far in the assessment and control of public procurement. This transition is largely the key to the synthesis of the legal and economic levers of the anti-corruption policy in the public procurement sphere.

The second conceptual approach to curbing corruption in public procurement builds on the classical individual behavioral model to explain and counteract crime

in general. It explains **the individual motivation** for the use of opportunities for the extraction of private benefit (formulated above in the principal-agent model). The classic individual behavioral model stems from the expected personal benefit and the individual price that the perpetrator expects to pay, depending on the likelihood of detection and punishment. Hence, counteracting measures are most likely to be effective, are to be done at the level of individual incentives and disincentives concerning the corrupt interaction between the bribing party and the bribed party. They relate to the opportunities to detect, prove and punish the abuse which, in turn, correlates with the efficiency of the internal financial control system and the judiciary.

Corruption in the public procurement has its specific drives and brakes, putting the two anti-corruption models described above in a different light. What makes it different from the other types of fiscal corruption is the fact that it largely determines **the objectives and tools of political clientelism**. The mechanism is all too familiar. Like everywhere else in the world, political parties need the financial support of the business community for their electoral campaigns. Unlike in developed democracies, however, in the Bulgarian practices this support is considered as a business investment **not** to the benefit of the public but as a private investment of the respective sponsoring business in exchange of which the return is guaranteed in the form of privileges and benefits in the distribution of the public good once the sponsored party or “independent” candidate comes to power. This means privileged access to public procurement contracts, concession agreements and other forms of directing public resources into private accounts. Of course, part of these resources end up in the private accounts of those who make the decisions or exercise political control. This is not at the expense of the contractors; it is at the expense of taxpayers. Without competition, suppliers can always internalize the costs incurred for private incentives in the price of their supplies. Figure 1 illustrates, in principle, the cycle of such political “investment”. The sponsoring business supports the electoral campaign of its political ally. The objective of the sponsorship is victory in the elections, i.e. the conversion of money into votes. The business receives a return on its investment ( $M'$ ) through public procurement contracts awarded by those in government while the responsible officials get their personal benefit ( $M''$ ).

**Figure 1. Political economy of corruption in public procurement**



Except for the final stage M'', this scheme was openly defended and justified in a series of public statements of the MRF leader Ahmed Dogan in 2005 and 2006. Its ideological rationale is that by supporting their business sponsors political parties create jobs in their constituencies and enhance the standards of living of their voters. Insofar as all parties have their constellations or "loops" of businesses, society does not lose anything in the end. According to Mr. Dogan, parties compete for the interest of their members and that of society as a whole through their loops of businesses.<sup>2</sup> The problem with this conceptual scheme for legitimization of party-related loops of businesses is that it makes the market economy redundant to a great extent. One can ask the following question: why are market competition and transaction costs necessary if political parties can so efficiently allocate the scarce resources in the economy through political competition?

The above illustration is too schematic to fully reflect the whole diversity of the process. Unlike ordinary investments, political ones are associated with greater risks and uncertainty. They arise from the uncertain outcome of the political competition, the uncertain outcome of the campaign, as well as from the balance of forces within the supported party and hence the relative weight of the commitments to other sponsors. Furthermore, the financial parameters of the investment are clear enough, unlike its rate of return. What is paid for before the elections is the membership fee for the club of those who stand close to the government but the benefit from that membership is determined later on as the price of additional payments which might go to the officials in charge rather than directly to the political party. Besides, as major as it is, public procurement is only one element of the benefits from the membership of the club. The others might be related to concession arrangements, subcontracting for foreign contractors, issuance of licenses and permits for various activities and transactions, political shielding of the circumvention of the law, government posts abroad which are important for the business, and so forth.

<sup>2</sup> See *Report of the MRF Chairman*, Dr. Ahmed Dogan before the Delegates and Guests of the Sixth MRF National Conference, 1 April 2006; available online at: <http://www.dps.bg/cgi-bin/e-cms/vis/vis.pl?s=001&p=0037&n=000001&>

On the other hand, we can hardly put all the business partners of those in government under the same common denominator. Most of them compete for a membership in the club and their costs of avoiding risks during the electoral campaign are the greatest. Others, being companies owned by the party leaders or functionaries themselves join automatically. They do not need to make any investment in the party. Conversely, parties and other sponsors invest in them, involving them as partners, consultants or subcontractors for their supplies. Still others are so closely identified with a specific political party that their business cycle largely reflects the life cycle of the party. There is also the group of those who have managed to outgrow their initial one-party affiliation and are now big enough to expect membership in any club, i.e. their money is welcome everywhere even at a later stage when the risks and uncertainty are reduced.

The level of government matters as well. In the case of local government, the smaller the municipality, the less the uncertainty and hence the greater the opportunities for local businesses to determine the membership and decisions of the municipal leadership. Of course, it is the objective of each business to expand and go beyond the boundaries of the region. Therefore, businesses need to invest in the central government, members of parliament, and senior government officials. Even further, the division of the public resources which takes place at the local level is still relatively small due to the incomplete fiscal decentralization in the country.

Large-scale corruption in Bulgaria underwent several stages during the country's transition to a market economy. In the early 1990's, when democracy and the rule of law were quite fragile, political corruption was mainly in the form of pumping resources out of the state-owned enterprises and their preparation for cheap privatization. The newly established private businesses stood at the input and output of state-owned enterprises with the participation of the management of the latter. Against the backdrop of the underdeveloped market economy and the price liberalization, they got the opportunity to bleed state-owned enterprises out and the state budget thanks to the soft budget constraints prior to the introduction of the currency board arrangements. Thus, the economic shock-therapy and financial liberalization of the early 1990's, together with the delayed structural reforms and the soft budget constraints, created opportunities for channeling assets of the public sector to privileged private groups. After the crisis in 1996-7 and the introduction of the currency board, those structures which were the main factor for the delay of the reform processes turned into major participants in the privatization. That process created the specific Bulgarian features of what the World Bank experts called "state capture".<sup>3</sup>

That early post-communist stage of development of Bulgarian business generated also a specific form of financing of political parties through institutionalized administrative corruption which, for many years, determined the high corruption risk in the customs administration and the links of parties to organized crime.

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<sup>3</sup> Hellman, Joel S., Geraint Jones and Daniel Kaufman *Seize the State Seize the Day: State Capture, Corruption and Influence in Transition*, World Bank Policy Research Working Paper No. 2444, September 2000

In the early years of the transition, new democratic entities could not rely on the financial support of businesses. They were either too weak and inexperienced in political investment or genetically linked to the former communist party. Therefore, the only venue they had was the government, which brought about a more rudimentary form of using administrative instead of political corruption for party financing. At that point of time, the long suppressed consumption unleashed a real boom in the importation of consumer goods, on most of which high customs duties or even excise taxes were levied. The tariff and excise tax evasion brought huge profits to the importers as a trade-off to a payment of a certain rate for each container imported. Participants in those schemes say that a certain portion of each bribe paid to the customs administration was distributed further up to the chain of government all the way to party treasuries. At the end of the 1990's, many customs duties were either reduced or removed and the scope of excise duties was confined to the typical excise goods (fuels, tobacco, alcohol and some luxury products).

At the same time, parties already had their business partners and this primitive form of party financing through customs corruption became relatively inefficient. Some smuggling channels were legalized and moved away from the gray sector of the economy, while others, where customs duties, VAT and excise taxes continued to be the sources of considerable profit, shifted to the black sector. Besides, the target of political corruption moved toward the privatization process rather than imports. The consequences of those early forms of using organized administrative corruption for financing political parties continue to shape the specific features of the corrupt and criminal environment in Bulgaria. On the one hand, they determine the deep links among smuggling channels, businesses and politicians and, on the other, they demoralized the regular customs officers for a long time to come and impeded anti-corruption measures.

Today, the political corruption in Bulgaria takes much more developed and larger-scale forms, where public procurement occupies a sizeable place. After the privatization process was basically completed in the beginning of this decade, public procurement and concessions became a major sphere of large-scale corruption. Their place on the top of the pyramid of corrupt practices is determined by the large financial resources distributed within the public procurement system, and the related opportunities for personal enrichment. Also, precisely for that reason, financial abuse cannot happen without the involvement of and protection by high-level officials, and, finally, by the enormous economic and fiscal price that society has to pay.

On the other hand, the relative weight of financial abuse by sectoral contracting authorities is increasing. Such restructuring of the conventional corrupt practices depends also on the growing share of contracting authorities in this sector, and the relatively limited opportunities for public control. The third chapter of this study deals with the corruption risk and corrupt practices in the public procurement for the energy sector in Bulgaria.

## 1.2. RESPONSIBILITY: POLITICAL OR ADMINISTRATIVE, COLLECTIVE OR INDIVIDUAL

Unlike the other cases of fiscal corruption, public procurement involves mainly high-level corruption. The head of the institution or enterprise in the public sector is fully responsible for the awarding and implementation of public procurement contracts. The appointments of the leader are typically political, as are those of the board members in state-owned and municipal enterprises. Nevertheless, the cases of such corruption almost never reach the stage of holding anyone politically accountable. Rather, they often end with claims and disputes about the political merit for the detection of abuse at the lower levels of government. From here then the tendency of those in government<sup>4</sup> to explain public procurement corruption, at least the violations reported, as being part of the administrative corruption.

There is another common and disputable argument in the public debate concerning the anti-corruption measures in the public procurement sphere. Even when the issue is considered within the framework of political corruption, the tendency is to associate it primarily with the financing of political parties. Hence the anti-corruption measures tend to focus on the increase of government subsidies for parties. It is important then to examine these two theses from the perspective of the anti-corruption policy.

**First**, is it possible for some of the abuses in this sphere to be in the scope of administrative corruption, i.e. to be unrelated to any collective partisan interests or individual interests of those in government? In other words, is it possible for the acquisition of goods and services in the public sector to bypass the political leader and be the result of action at the lower levels of government? Such a risk exists mainly in the case of small public procurement contracts in central government institutions, as well as in municipal procedures or contracts in hospitals, schools and others. But it also exists in large-scale procurement procedures which require high level of professional expertise. In cases like this it is possible for the experts to set such public procurement parameters or assess bids in a way that gives advantage to a specific bidder. However, the opportunities for this type of corruption at the expert level are quite limited. This would mean that there are no other bidders or experts to address the head of the institution with their arguments and that there is no pressure on the head from above or from outside by competitors. Moreover, consultants are involved when the specificities of the public procurement procedure are as complicated. In fact, if there is a corrupt scheme, it would be activated as early as the stage of the selection of a consultant so that to ensure advantages for a given bidder through the parameters of the public procurement procedure.

To put it in brief, it is not impossible for corruption in the public procurement sphere to result from the lack of control over the lower levels of government, i.e. to be more of the administrative type than of the political type of corruption. In reality, however, this option seems to be more of an exception than a rule in

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<sup>4</sup> A recent example to this effect is the scandal with the abuses in the district heating company in Sofia (Toplofikatsia).



large-scale public procurement contracts. It affects mainly small public procurement contracts. In 2006, the value of the contracts below the thresholds set out by the Public Procurement Act accounted for 6.3 % of all contracts. Although this small share was due mainly to the huge contract for the construction of Belene NPP, which was worth 7.82 billion leva, even without it, small contracts did not exceed 19 % of the total value. It is even more important that the “small” corruption in the public procurement sphere does not relieve those in government from responsibility. In general, the corruption in the public procurement sphere is dominated by well-structured networks of targeted investments rather than by occasional actions of individuals at the lower levels of government due to negligence of their superiors. Therefore, this study is interested in analyzing this type of corruption as the driving force and tool of high-level corruption. This leads us to the **second** question: what is the driving force of corruption in the public procurement sphere – the need for financing political parties or the individual aspiration of politicians for private benefit?

When the objective is power, the benefits from the unlawful awarding of public procurement might go to the respective political party, i.e. to be associated with the financing of political activities aimed at coming to power. The roots of the use of government power for financing political parties are very deep indeed, dating back to the long years of the symbiosis between the party and the state. Some argue that, in such cases, the objective is not personal gains but it is the party itself or, even during the transition years, democracy itself. Is it possible that the ultimate goal of the abuse of public procurement would be the victory of the party cause rather than the victory of the people identifying themselves with it? Hopefully, politicians view power only as a tool to resolve the problems of their voters before they tackle their own problems. In this sense, in theory, it is possible to assume that if corruption in the public procurement sphere is used for financing political parties, it might not necessarily be directed to personal benefits. In practice, however, where corruption is used for undemocratic and non-transparent transferring of public resources to partisan treasuries, the ultimate goal is more power for the leaders and functionaries of the respective party. The purpose and use of government powers is another issue but it would hardly be realistic to accept that they are related primarily and only to the interests of their voters. They are more closely linked to personal interests, no matter whether the personal gain from coming to power is expressed in the form of money, power, or simply a lucrative public or corporate position. In the end, the benefit for the party as motivation for financial abuse within the public procurement sphere is ultimately aimed at personal benefit.

Advanced democracies try to restrict these opportunities through greater transparency of party financing and accountability of political parties. In Bulgaria as well, anti-corruption measures are, first and foremost, oriented toward legislation concerning the financing of political parties. In this context, the thesis that an effective anti-corruption measure is the increase of the budget subsidies for political parties has become increasingly relevant. The argument goes that if parties had “enough” money, they would not use government power to derive financial benefits. So far though, there is no sound evidence to confirm this thesis neither in theory, nor in practice both at the individual level (pay rise for government officials) and at the group (party) level. This thesis would have some limited justifications if the

use of power for financing parties or benefiting party sponsors was totally selfless, i.e. geared only toward the attainment of the party goals and in the interests of its members or supporters. Even in such a case there would hardly be a level of subsidy to be sufficient for all participants, i.e. to optimally reduce the economic incentives for political parties to resort to financing through political clientelism.

More frequently, high-level corruption results not from the striving to finance party activities and goals but from the aspiration of individual senior functionaries to use the government power to their own benefit, including direct financial gains. In this sense, high-level corruption results from the lack of inner-party democracy, transparency and control. After 16 years of transition, the political parties in Bulgaria today have unstable and frequently small or amorphous membership, incomplete structures, and therefore fragile democratic traditions. In short, parties lack sufficiently effective protection from being used for personal enrichment by individual senior functionaries. This drives away some of their supporters which, in turn, makes their dependence on political entrepreneurs and coalition or financial trade-offs bigger, increasing the risks of voter apathy and marginalization of the election process as a result.

The organizational weakness of political parties is among the major reasons for the lack of democratic control over the inner-party decision-making process. This explains the existing tendency in Bulgarian politics to rely more on the leader than on the party and the ideas it puts forward, i.e. to seek the “messiah” instead of the full use of the tools for civil control over holders of elective office. The result is a certain level of popular withdrawal from conventional parties and the search for some new forms of civic association and non-partisan representation.

In a nutshell, the crisis of political representation in Bulgaria - largely the result of voters being disillusioned by high-level corruption - has caused the main political parties to be dominated by a strong leader and has blurred the ideological distinctions between them. Political corruption has thrown political representation in the country into a downward spiral. In turn, the resulting emergence of domineering party leaders is isolating the parties from their voters and is increasing the risk of corruption. The fortunes of leaders thus end up depending not so much on the support of voters and sympathizers but rather on their ability to manipulate the party's top brass.



## 2. CORRUPTION RISK AND CORRUPT PRACTICES

The issue of the critical levels of political corruption in Bulgaria has been central to the public debate since the late 1990's. This is largely due to the regular corruption assessment reports through the Corruption Monitoring System of *Coalition 2000*, as well as the surveys of the Bulgarian Industrial Association and other non-governmental organizations. The latest monitoring reports of the European Commission on Bulgaria's preparedness for membership of the European Union have also put forth the problem of political corruption.<sup>5</sup> The reports identify the magnitude of high-level corruption and organized crime as the largest challenges to EU membership, relating it directly to the inefficient judiciary and the lack of effective court sentences. Europe's sensitivity to this topic upon accession is fully understandable. During the first seven years of its membership Bulgaria will get access to substantial financial resources from the structural, cohesion and agrarian funds in the approximate amount of € 8 – 9 billion.<sup>6</sup> The efficiency of European grant schemes depends primarily on the good governance and control systems at the central and local level. Political corruption in the allocation of EU funds to certain Bulgarian businesses and politicians would expose not only Bulgarian but also European taxpayers to the threat of direct losses.

*The National Strategy for Transparent Governance, Prevention and Countering of Corruption 2006-2008* identifies public procurement as a sphere with the highest corruption pressure because, together with concessions, public procurement is the main channel for directing public resources to the private sector. Let us, first of all, try to assess the scope of the problem and the related damage on the basis of an assessment of the size of the "market" for public procurement in Bulgaria. For the purposes of this study, with the caveat that the definition is quite conditional, we could define this market as **the consumption of construction works, goods and services, which is carried out within the framework of the procedures and rules set out in the legislation for the awarding and implementation of public procurement contracts.**

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<sup>5</sup> See European Commission COM (2005) 534 and COM (2006) 549.

<sup>6</sup> National Strategic Reference Framework (version dated 14 September 2006) available online at <http://www.eufunds.bg/docs/>

## 2.1. THE PUBLIC PROCUREMENT MARKET

The term “public procurement market” is used here conditionally. In order to assess the corruption risk in this sphere, we use it to define the consumption of goods, services and construction works in **the public sector and the utilities**, for which the legislation provides specific procedures to award and implement public procurement contracts. In other words, the definition rules out the consumption in which the choice of a supplier or a contractor does not require any specific procedure. According to Bulgarian laws, these are the public procurement contracts the value of which is below 100 thousand leva for construction works and 30 thousand leva for the supply of goods or services. In this context, the public procurement market includes most of the current and investment consumption of the central and local government bodies and institutions, as well as the legal entities they finance and/or manage. These are the so-called “conventional” contracting authorities in the public procurement sphere. The public procurement market covers also the consumption by sectoral contracting authorities. These are the network suppliers of public services in the energy sector, water supply, transportation, and postal services. Regardless of whether they are public or private, due to being natural monopolies and due to the fact that their (in)efficiency is of huge importance for society, their current and investment consumption is covered by the legal framework regulating public procurement.

**Volume and structure.** The value of the public procurement contracts awarded in 2005-2006 was 15,176 million leva,<sup>7</sup> which was about 17% of the GDP generated in these years. This number gives a somewhat distorted picture of the actual size of the public procurement market in Bulgaria since more than half of it accounted for a single transaction, i.e. the contract for the construction of the two units of the Belene Nuclear Power Plant (NPP) worth 7,817 million leva which was concluded in 2006. Therefore to give a more valid picture, the figures concerning the public procurement market are presented here with and without the NPP contract. Leaving Belene NPP aside, the value of the public procurement contracts signed in Bulgaria accounted for some 8% to 9% of the country's GDP (Table 1).

**Table 1. Total value of public procurement contracts in Bulgaria 2005-2006 (mln leva)**

	2005	2006	2006*
Total Value	3,296.0	11,879.8	4,061.8
Share of GDP	7.9 %	24.2 %	8.3 %

\*Without Belene NPP; GDP forecast for 2006 is 48 billion leva

Source: Public Procurement Agency (PPA), National Statistical Institute and own calculations

<sup>7</sup> Net of VAT

The increased corruption risk in public procurement is largely associated with the fact that this market is strongly dominated by construction works. In 2006, construction works accounted for 83% of the total value of all contracts but a longer period of monitoring would probably reveal that such a high percentage is rather an exception due to the contract for Belene NPP. Leaving that aside, construction works accounted for half of the total value of the public procurement contracts signed in Bulgaria. About one-third of all contracts relate to the supply of goods and about one-sixth cover the provision of services (Figure 2).

**Figure 2. Structure of the public procurement market (% of contracts)**



Source: PPA

As to the supply of goods, over 40% of the value of the contracts covers four industries: the chemical industry (mainly pharmaceuticals), machinery and equipment, fuels, and medical instruments and equipment. The ranking of the most consumed goods reveals that the health sector is the largest consumer of goods in the public sector. The leaders in the public procurement market for services are business services, waste management and environment protection, as well as repair and maintenance works.

These three service sectors, together with the four sectors concerning goods, account for approximately two-thirds of the value of all contracts awarded during the period under review.

**Table 2. Value of the contracted goods and services by sectors in 2004-2006 (net of VAT)**

Sector (Classification Group in the PP)	mln levs	Share
1 Chemical industry (24-25)	463.02	42.3 %
out of which pharmaceuticals (244)	408.63	
2 Machinery and equipment (29),	404.70	
out of which turbines and reactors (291)	69.43	
3 Oil products and fuels (23)	402.59	
4 Medical and other instruments and devices (33)	357.02	
out of which medical equipment (331)	267.95	
<b>5 Professional and business services (74)</b>	<b>342.04</b>	
<b>6 Waste management and protection of the environment (90)</b>	<b>317.77</b>	<b>24.4 %</b>
<b>7 Repair and maintenance works (50)</b>	<b>281.13</b>	
8 Office and computer equipment, of which (30)	187.52	
office equipment (301)	47.18	
computer equipment (302)	83.13	
9 Semi-finished products (28)	173.25	
out of which, metal products (281-287)	110.88	
building materials (288)	63.44	
10 Electrical machines and equipment (31)	126.03	
11 Motor vehicles (34)	93.99	
<b>12 Financial services (66-67)</b>	<b>80.55</b>	
13 Food, beverages, tobacco products (15-16)	77.62	
14 Textiles, garments and leather products (17-19)	62.36	
15 Energy (40)	53.82	
out of which: nuclear fuel (405)	1.23	
16 Other goods	262.87	
17 Other services	163.76	
<b>Total</b>	<b>3,850.04</b>	

Source: Public Procurement Agency, the data cover the period from 1 October 2004 to 30 June 2006.

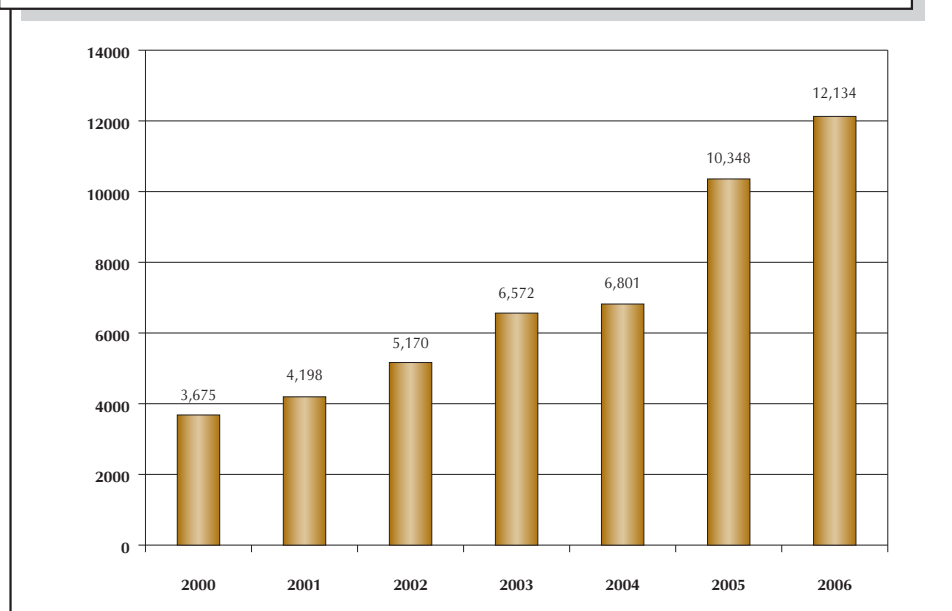
Service sectors are highlighted.

These figures relate to the **registered** public procurement market in Bulgaria. The actual size of the public procurement market is 20% to 25% larger. It includes transactions which are not subject to registration (for instance, those related to national defense and security), as well as transactions which are subject to registration but have not been registered for various reasons. It also includes transactions concluded without any tender procedure regardless of legal

requirements for that. Thus the size of the public procurement market in Bulgaria today can be estimated at approximately 10% to 12% of the GDP, i.e. 4.5 - 5.5 billion leva in 2006.

**Dynamics.** The difficulties in the assessment of the volume of the public procurement market in Bulgaria are partially due to its high growth rates and the fact that it is far from its equilibrium state. Only two years ago, the average annual size of the public procurement market was put at 1.8 - 2 billion leva (5 % of GDP) on an average annual basis,<sup>8</sup> while today it is some three times larger. Figure 3 shows the almost quadrupling of the number of contracts between 2000 and 2006. Part of that growth resulted from the increase in the registered contracts and perhaps covered mainly lower value market segments. Therefore growth rates were more modest in value terms but they were equally impressive. These high growth rates of the value of public procurement contracts in the initial years of Bulgaria's EU membership will continue, coming closer to the EU public procurement average market size of 16.3% of GDP. Moreover, growth will be further fuelled by the drive for Bulgaria to quickly overcome gaps in its basic, communication and environmental infrastructure to meet the requirements of the European internal market. This is the purpose of the substantial amount of EU funding to be allocated to Bulgaria in the first 7 years of its EU membership. A large portion of the money entering the country through the EU structural funds will be distributed via the public procurement procedures. The public procurement market can be expected to grow by an average of 6% to 7% per year during the first seven years of membership. According to the most conservative estimates (i.e. without the sizable transactions of the Belene NPP type), this implies that the average annual volume of the market will reach 6 - 7 billion leva in 2007-2008.

**Figure 3. Number of contracts awarded in 2000-2006**



Source: Public Procurement Agency,

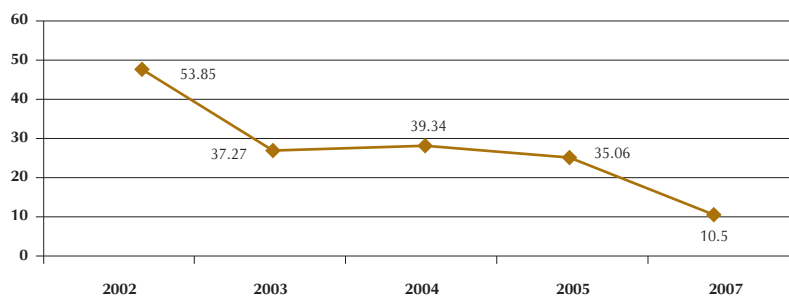
<sup>8</sup> See BIA, *Public Procurement Monitoring: The Most Common Violations and Corrupt Practices*, Sofia, p. 4 (<http://www.bia-bg.com/files/ZOP-broshura-2005.rtf>).

## 2.2. LEVEL AND SPREAD OF PUBLIC PROCUREMENT CORRUPTION

It is to be expected that this large and very dynamic market of the Bulgarian economy and the related opportunities for excessive profit and non-market and/or non-regulated income it creates would generate strong incentives for both suppliers of goods and services and contracting authorities to resort to corrupt behaviors.

Despite that, the data from the Corruption Monitoring System (CMS) of the Center for the Study of Democracy point to a downward trend. Five years ago, every other company participating in a public procurement procedure admitted to paying a bribe; in 2005, one in three respondent companies shared such an experience, while in 2007 only one in ten companies paid a bribe in public procurement (*Figure 4*).

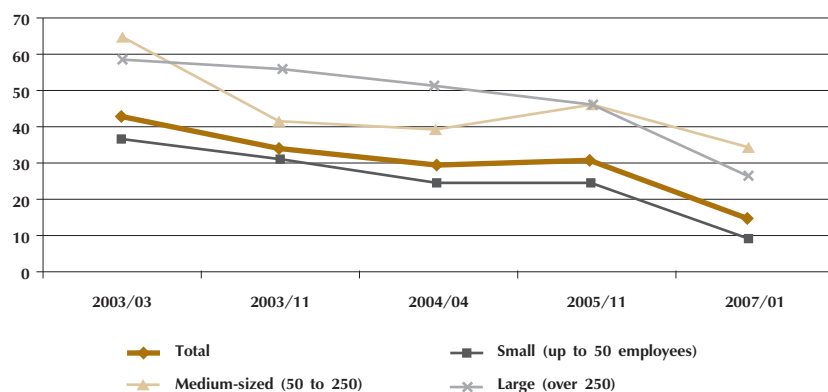
**Figure 4. Share of the companies which resorted to bribery in the public procurement market**



Source: Vitosha Research

However, some caveats apply to these optimistic results. Other CMS indicators raise the issue whether these statistics are indicative of reduced corruption in the public procurement sphere or rather of its institutionalization, i.e. its migration from the medium administrative level to the higher levels of the executive power and its transformation from occasional deals to closed corrupt networks known as “loops of companies”. Several arguments tend to tilt the balance to the latter conclusion. First, the suspected concentration of public procurement corruption into the higher levels of government is corroborated by the reduced number of participants in public procurement tenders. Fewer and fewer companies, especially new entrants, take part in the announced procedures. Since 2003, the share of the companies which have participated in public procurement procedures has decreased by two-thirds: from 43 % in 2002 to 14 % in 2006 (*Figure 5*).

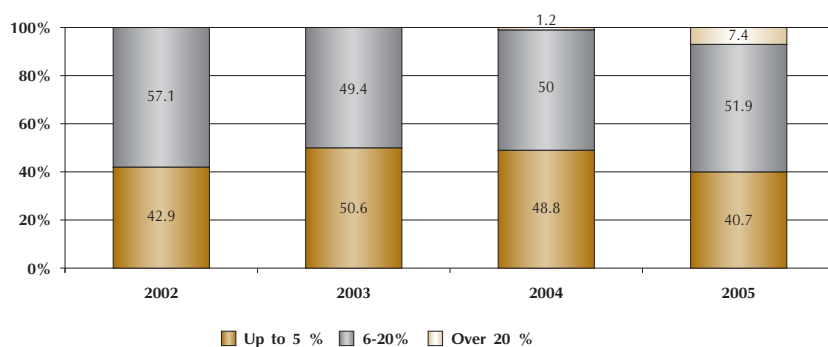
**Figure 5. Share of the companies which took part in a public procurement procedure (% of the respective group)**



Source: Vitosha Research. The month and the year indicate the time of the respective survey, reflecting the experience of the respondents in the previous year

Second, the size of the bribes has increased (*Figure 6*). Finally, the victimization surveys underlying the CMS give the best reflection of the personal involvement in corrupt practices where respondents perceive themselves as victims. In other words, they reflect the intensity of the administrative corruption in the public procurement sphere. Their capacity to gauge the large-scale political corruption within public procurement is limited. Businesses are accomplices rather than victims in this case.

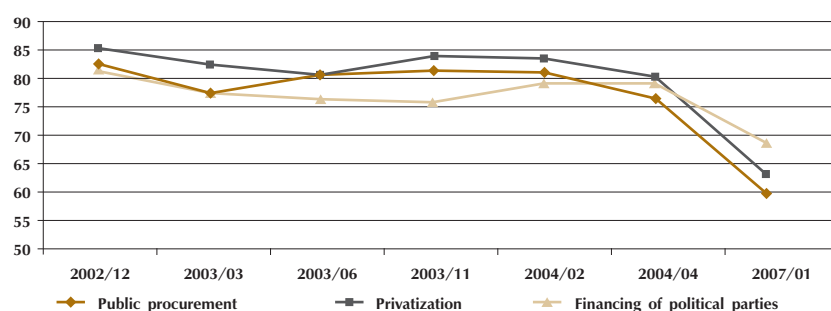
**Figure 6. Size of the bribe as percentage of the transaction**



Source: Vitosha Research

This is confirmed also by the CMS indicators which show the assessment, rather than the personal involvement, of entrepreneurs of the level and spread of corruption in the public procurement. Although there are signs of a decline, 60% of the Bulgarian companies still assess corrupt practices in the public procurement as “widespread” (Figure 7).

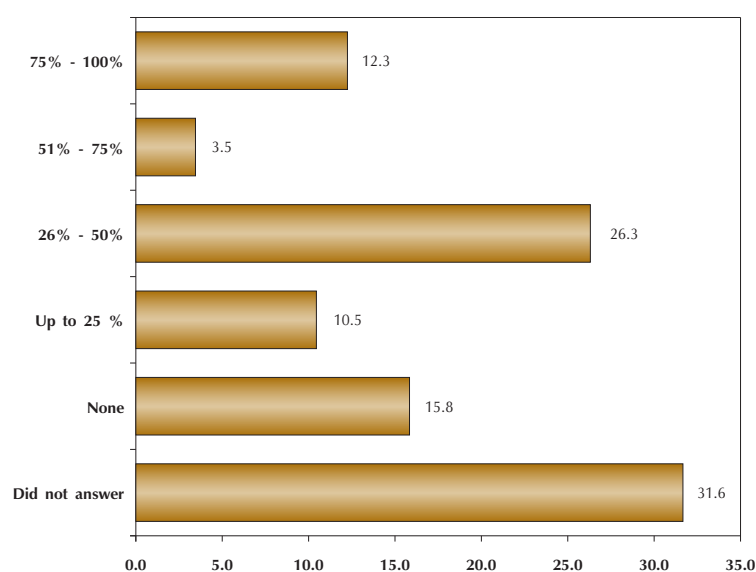
**Figure 7. Assessment of the spread of corruption in the public procurement sector given by businesses (% of those respondents who answered that it was widely spread)**



Source: Vitosha Research

42% of the Bulgarian entrepreneurs assess the share of discredited procedures in their industry to more than 25%, and one in eight companies states that procedures are strictly followed only in less than 25% of the cases (Figure 8).

**Figure 8. Share of discredited procedures in your industry (% of the participants in public procurement procedures who specified the respective percentage)**



Source: Vitosha Research



Besides sociological (soft) data, there are some hard data proving the relatively high levels of corrupt practices and corruption risk within public procurement. For instance, a good measure for the substantial corruption risk in this sphere is the share of regulation violations actually detected (*Table 3*). The relative share of discredited procedures in public procurement in Bulgaria in value terms is more than 50% according to the findings of internal auditors. In 2005, the Bulgarian Public Internal Financial Control Agency (PIFCA) audited 6,399 procedures (some 60% of all registered) at a total value of 1.2 billion leva and found out violations of procedures in 1,609 cases at a total value of 567 million leva. Some three-quarters of the revealed violations refer to small scale public procurement which accounts for only 9% of the violations in monetary terms. Over 91% of the value of revealed irregularities were for procedures regulated by the Law on Public Procurement (LPP).<sup>9</sup> Furthermore, the internal audit found that authorities failed to hold public procurement procedures for projects in the amount of 98.5 million leva, although the grounds for holding them existed. This adds up to a total of 666 million leva in violated procedures and failure to hold procedures in 2005 or 56% of the value of all procedures checked by PIFCA. Such a high level of non-compliance can hardly be explained with procedural mistakes as a result of legal incompetence or administrative inertia and lack of interest. Instead, it rather testifies to widespread corrupt practices.

**Table 3. Results of the internal audit of public procurement contracts**

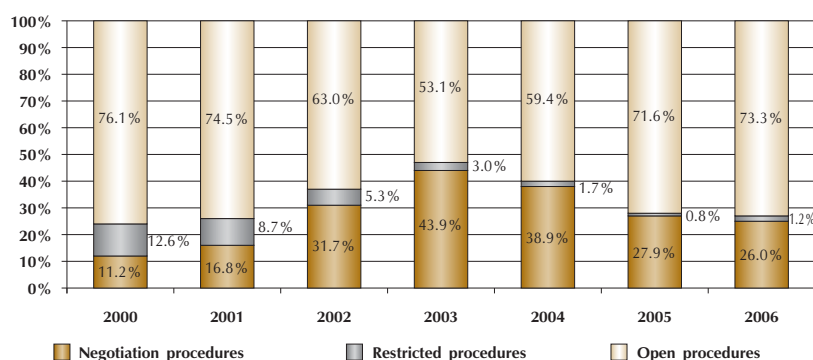
	2003		2004		2005	
	Number	mln. leva	Number	mln. leva	Number	mln. leva
Registered procedures (1)	6,572		6,801		10,583	3,296.0
Audited (2)	6,096	729.1	5,624	988.0	6,399	1,200.0
Violated procedures	1,941	350.0	1,479	249.5	1,609	567.0
Violations established			2,154		2,551	567.0
under the LPP					651	515.3
under the RSPP					1,900	51.7
Failures to conduct procedures	820	85.0	484	79.8	641	98.5
<b>Total violations and failures (3)</b>	<b>2,761</b>	<b>435.0</b>	<b>1,963</b>	<b>329.3</b>	<b>2,250</b>	<b>665.5</b>
Share of audited procedures (2/1)	92.8%		82.7%		60.5%	36.4%
Violations/audited procedures ratio (3/2)	45.3%	59.7%	34.9%	33.3%	35.2%	55.5%
Violations/registered procedures ratio (3/1)	42.0%		28.9%		21.3%	20.2%

Source: PPA, PIFCA

<sup>9</sup> See Report of the Public Internal Financial Control Agency for 2005, Sofia, May 2006, [http://www.advfk.minfin.bg/files/docs3\\_2005.pdf](http://www.advfk.minfin.bg/files/docs3_2005.pdf)

Another useful indicator of the corruption risk level in public procurement is the share of the contracts signed through various forms of negotiation with the contractor, i.e. without full prior disclosure of the parameters of the procurement in advance. First and foremost, it should be pointed out that such procedures are not only provided by law but, in the case of some complex transactions, they are desirable to guarantee the best protection of public interest. From the entry into force of the *Law on Public Procurement* in 1999 to its amendment in 2004, however, the share of procedures employing negotiations rather than open competition tenders tripled, reaching a peak of 44% in 2003 before falling back again (*Figure 8*). This growth could possibly be related to more diligent reporting compliance (i.e. entering of the transactions in the Public Procurement Register). Nevertheless, these figures show that corruption pressure is concentrated largely in the negotiation type procedures of public procurement. The experience with the amendments of 2004, however, clearly shows that corruption can be substantially reduced through more strict regulations concerning the application of the procedures.

**Figure 9. Share of the procedures involving negotiations  
(% of the number of contracts awarded in 2000– 2006)**

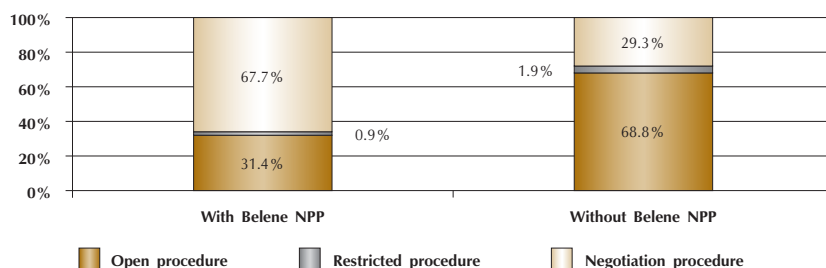


Source: *Public Procurement Register (2000-2004); Public Procurement Agency (2005-2006).*  
*In 2005 and 2006, the procedures involving negotiations included both negotiations with announcements and negotiations without announcements under the LPP and the RSPP.*

Data about the relative share (in value terms) of procurement procedures based on direct negotiation, i.e. without competitive bidding, are more useful for corruption risk assessment. The estimates for 2005-2006 (*Figure 10*) reveal that it is much higher than their share in the total number of procedures.<sup>10</sup> However, the data cover only a short period of time and, besides, they include the Belene NPP deal. Therefore they are used here rather as a point of departure in the corruption risk assessment and not so much as the basis for any firm conclusions.

<sup>10</sup> The Public Procurement Register does not provide such statistical information for 2000-2004 (prior to the establishment of the Public Procurement Agency). The PPA data used here cover the period from 1 October 2004 to 30 June 2006.

**Figure 10. Share of the procedures involving negotiations  
(% of the value of the contracts awarded)**



Source: Public Procurement Agency (2005-2006). The data in value terms cover the period from 1 October 2004 to 30 June 2006. In 2005 and 2006, the procedures involving negotiations included both negotiations with announcements under the LPP and the negotiations with invitations under the RSPP.

The growth of corruption in the public procurement sphere was noted also by external observers. According to the report of the European Bank for Reconstruction and Development (EBRD) on transition economies in 2005, public procurement corruption was the only one to worsen in Bulgaria over the period between 2002 and 2005.<sup>11</sup> In terms of that indicator, Bulgaria ranked second-to-last in South-Eastern Europe (before Albania) and it was the only country to report deterioration over time.

## 2.3. THE COST

The issue of the economic cost of corruption in the public procurement sphere is important from the perspective of the ex-ante impact assessment, i.e. the selection of anti-corruption instruments, and the ex-post assessment of their efficiency.

First and foremost, corruption in the public procurement sector causes direct fiscal damage. It is due to the artificially inflated prices of supplies, which include excessive profits for the suppliers and the corruption income of the responsible officials. Despite this the corrupt interaction does not always lead to excessive costs. More often than not beating of competition in an open tender requires for lower delivery prices. Then the excessive profit for the supplier and the bribe the contracting authority are a result of the compromises with the quality and the parameters of the supply contract. In other words, there are no excessive fiscal costs but there are welfare losses because society does not receive the public goods in the quantities and the quality it has paid for. Quite frequently these compromises could lead to higher costs in the operation or consumption of the goods and services supplied under a particular public procurement contract, i.e.

<sup>11</sup> The EBRD conclusions in its *Transition Report 2005* are based on data from Business Environment and Enterprise Performance Survey in Eastern Europe and Central Asia for 2002 and 2005.

transfer of budget spending further in time or to other institutions, beyond the time-line of the specific tender.

The accurate assessment of the fiscal damage in the form of unjustified excessive spending or other public loss as a result of violating the procedures is a difficult exercise based on many assumptions. A somewhat useful point of departure is the information from the Bulgarian internal audit agency with regard to the reported violations listed in *Table 3*. The total value of the infringements of statutory requirements in 2005 was approximately 666 million levs or 56% of the total value subject to internal audit in the public procurement sector. If this percentage is extrapolated to the estimated size of the whole public procurement market (4 - 5 billion levs in 2005), the total value of compromised procedures would reach 2.2 – 2.8 billion levs.

This amount reflects the value of infringed procedures but not the value of the violations themselves. In other words, it is not equal to the fiscal damage caused by corruption. The latter is equal to the excessive rent derived by the contracting authority and the contractor for their personal benefit due to the suppression of competition. The differential between the market price of the supply of the procurement and its tendering price (or the discrepancies in the quantity and quality of the procurement respectively) constitutes the real loss to society. The excessive rent generated by corruption and the lack of competition, although more easily seen at the level of individual transactions, can hardly be calculated at the macro-level. If we assume that it is divided equally between the parties in the corrupt deal, then the losses for the budget would be double the amount of bribes in this sector. According to CMS of the Center for the Study of Democracy in 2005, the average size of the bribe within the public procurement sector accounted for about 7 % of the value of the contract.<sup>12</sup> This implies that, in a conservative scenario, the average amount of the excessive profit generated by corruption and the lack of competition within the public procurement sector is approximately 15%. Since the value of infringed procedures is 2.2 – 2.8 billion levs, the losses resulting from financial abuse in the public procurement would range between 330 million and 420 million levs.

The expected amount of losses should be considered as an underestimate for a number of reasons. First, it reflects a conservative estimate of the potential size of the public procurement market at 4 – 5 billion levs. Second, it is based on a quite optimistic estimate of the efficiency of the internal audit in Bulgaria. In other words, it builds on the assumption that the frequency of violations in the procedures outside the scope of the audit is similar to that in the audited procedures. In fact, if there was an efficient risk assessment and management system, the degree of deviation in the audited procedures should have been even higher than in the rest of the procedures. In this case, a lower estimate for the total number of irregular public procurement procedures would apply to say about 40 – 45% of the awarded contracts. This, however, would only be a realistic assumption in the case that an independent inspection with proven professionalism and integrity existed in Bulgaria.

<sup>12</sup> *On the Eve of EU Accession: Anti-corruption Reforms in Bulgaria*, Center for the Study of Democracy, Sofia 2006, p. 29.

Does the former Public Internal Financial Control Agency, currently the Public Financial Inspection Agency at the Minister of Finance, meet this definition? Are businesses right to suspect that its activities are influenced by political pressures and that most of the violations are found in the small public procurement contracts at the lower levels of government? Some grounds for such doubts can be seen in the data contained in the latest internal audit report of 2005.

According to that report, the procedures audited in 2005 accounted for some 60% of all procedures but only 36% of their total value (See *Table 3* above). Some 75% of all detected violations were small-scale public procurement, as defined by the law, but they accounted for only 9% of the violations in total value terms. One can conclude that the strict internal audit covers primarily the lower market segment, i.e. the administrative aspects of the risk of corruption. If that were the case, an assumption about a higher percentage of infringed procedures in value terms would probably be closer to actual levels.

Finally, the assumption concerning the amount of the rent could also prove quite conservative. International studies show that the size of the bribe is usually very small compared to the benefit it provides for the supplier. Moreover, in the case of political corruption, the classical cash kick-back has limited application, giving way to other types of benefits and protection: support and financing for electoral campaigns, securing employment after resigning from a governmental or administrative position, scholarships for close relatives, safeguards against criminal prosecution, etc. If that was the case, the more realistic estimate for the excessive profit generated by corruption in the public procurement market in Bulgaria could amount to 25% to 30%, which effectively doubles the assumption on the damage caused to society.

To sum up, if we abandon all conservative assumptions underlying the above-mentioned optimistic estimate of the fiscal losses from corruption in the public procurement sector, they could reach 1 billion levs annually, i.e. some 20 - 25% of the size of the market or approximately 2.4% of GDP. All this leads to the conclusion that the actual size of the losses from public procurement corruption tends to come close to such a level.

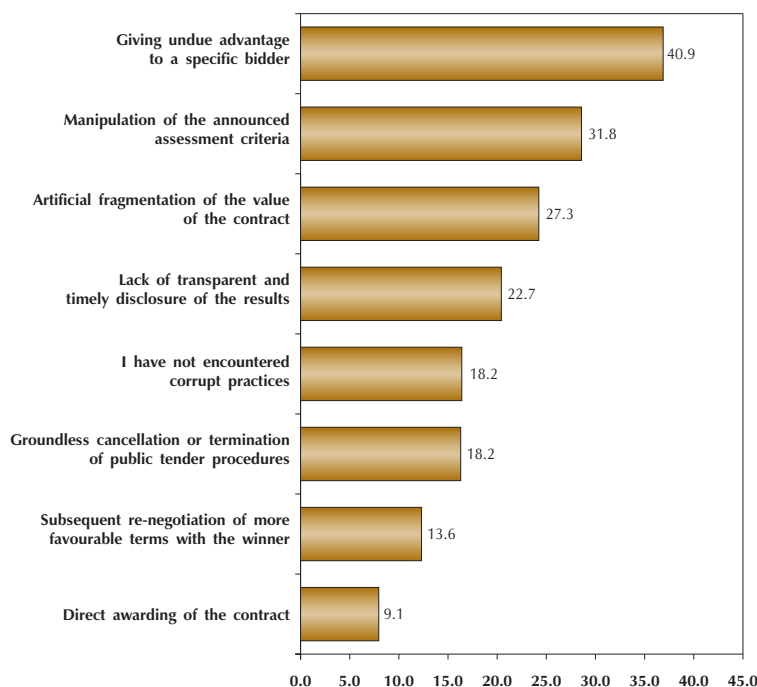
Corruption in the public procurement sector not only generates losses for the public sector but it also inflicts economic damage to the private sector which could be much greater and more overarching than the fiscal damage. The direct economic damage is associated with the losses of bona fide traders who could be more productive than those who win tenders by bribing. Because of corruption, the market cannot recognize and reward their productivity. Market distortions occur and generate disincentives on the supply side and hence the damage is partially transferred to consumers through the prices charged on the market. Corruption within the public procurement could be also an instrument for attaining oligopoly on some markets, where the excessive profit generated from the public sector makes it possible for corrupt companies to sell to private consumers at lower prices and thus crowd out the other, especially smaller firms from the market. Hence, the particular damage which corruption in public procurement causes to small and medium-sized enterprises.

Another indirect cost for fair businesses is the increase in the administrative costs for participation in public tenders. This is a result of the attempts by the public authorities to apply more and more administrative measures to curb corruption and financial abuse which increases the compliance costs for the companies, especially smaller ones.

## 2.4. AREAS OF INCREASED CORRUPTION RISK IN THE PUBLIC PROCUREMENT SECTOR

Most of the abuses in the public procurement field occur in the awarding procedures. These are the stages in which the tender documentation is prepared and bids are ranked. According to the survey conducted among businesses in January 2007, the most common infringements of rules, which participants in public procurement procedures in Bulgaria encounter are related to the ensuring of undue advantage to specific bidders (41 %), and the manipulation of the announced assessment criteria (32 %).

**Figure 11** What corrupt practices have you encountered in public procurement procedures? (% of the answers)



Source: Vitosha Research

What follows is a non-exhaustive list of the typical tools used for restricting the range of participants and the directing of the outcome of the tender procedure to the benefit of a specific participant in public procurement procedures.

**Direct non-compliance.** The direct non-compliance through contracts awarded in violation of the law without any tendering or competitive bidding procedure is still widely spread. Although this type of violation is observed mainly in the case of small-scale procurement by authorities in education, health and local government, the total effect of such violations is not small at all. In 2005, for example, PIFCA detected failure to hold due procurement procedures worth 98.5 million levs, up from 80 million levs in 2004. In other words, about one-fifth of the value of all reported violations is due to brazen disrespect of the law. Even if we assume that the detection rate is much higher in this market segment due to the direct nature of the violation and the relative lack of political protection in comparison to large-scale supplies, the relative weight of this type of violations in the total volume of damage (including the non-detected damage) seems significant. It is indicative of the insufficient deterrent effect of the sanctions compared to the benefits of the corrupt action. Although the action is most likely to be detected, the effective sanctions seem so soft that they could hardly compare to the benefits. An additional motive for such behavior in the case of school headmasters and hospital managers, for example, is the low level of salaries and the diluted control shared by the central and local government, which makes them feel immune to penalties.

**Circumvention of the law.** Another relatively less risky way of awarding public procurement contracts to pre-determined bidders is by breaking the supply into smaller parts, which fall below the tendering thresholds stipulated by the law, allowing the public authority to go for direct awarding. As it will be explained further in this paper, one of the techniques to modernize the public procurement system in Bulgaria has been to raise the thresholds in order to reduce the compliance costs for businesses in small-scale procurement. As a result, the current thresholds for obligatory tendering in public procurement are 100 thousand levs for construction works and 30 thousand levs for the supply of goods or services. These thresholds seem high for Bulgaria because they leave one quarter to one third of the public sector consumption beyond the scope of the existing legislation.

**Abuses in the definition of the parameters and technical specifications of public procurement procedures.** It becomes increasingly difficult, in most cases, to ignore or circumvent the tender procedures prescribed by law. Thus, corrupt contracting authorities use an alternative set of tools to direct the procedure so that the preferred bidder wins. One of the tricks employed is to put down such parameters and specifications of the procured product or service in the bidding requirements, which though not essential for the quality of the public good provided, rule out some bidders from the competition or directly predetermine the outcome. This is quite a widely used method and although it is quite easy to detect it, it remains relatively unpunished. In other words, it is one of the methods which obviously hamper fair competition but it is rarely punished as a violation of the law. It is usually applied when the contractor is selected in advance at political level and the stakes are so high that neither the supplier can



afford to lose nor the tendering authorities can afford the risk of failure for the conduct of an outright scam procedure with a predetermined outcome.

**Abuses in the definition of the selection criteria.** An alternative and not so overt instrument for directing the tender to the desired outcome, but also with a less clear result, is the definition of such selection criteria which leave sufficient room for discretion and manipulation of results. Usually, this is achieved by enhancing the share of the qualitative indicators at the expense of quantitative ones, such as the price and other measurable technical parameters. Some criteria could be too abstract or outright useless for the assessment of the relevance of the supplied product to the satisfaction of the public consumer. Examples of such criteria are “quality of the proposal” or “vision for the development of the sector”.<sup>13</sup>

Others are related to the assessment of the supplier rather than the supplied good or service. These are for example all the so-called “guarantees” for the capacity of the supplier to deliver the procured product in connection with specific experience, annual turnover or participation in similar tenders. The logic of such “insurance” on the part of the contracting authority is acceptable to a certain extent but, in practice, it restricts competition and confines the public procurement market to a narrow range of pre-selected eligible bidders. It leaves out companies which could offer better and more innovative solutions but lack the required “eligibility” to reach consumers.

Even the quantitative parameters of public procurement can be deliberately manipulated to make the direct comparison of bids more difficult and to increase the chance for applying administrative discretion in the selection procedure. Finally, even the price, which typically weighs a lot in the assessment (most frequently it forms more than 50 % of the final evaluation result), is only one of the cost elements. Manipulative pricing can often display publicly only the immediate costs of a facility without taking account of potential increase in the operational costs of the facility in the future. A more objective criterion would be the direct comparison of the overall net present value of alternative projects. It also includes the discounted future expenditures for the maintenance and operation, including warranty support, spare parts, consumables, etc.

**Manipulation of the assessment and ranking.** Next, even if all selection criteria are well chosen and specified, the end result can still be manipulated to the benefit of one or another bidder. A kind of guarantee against such practices seems to be the use of a pre-selected formula to calculate the final assessment comprising of all the quantitative and qualitative indicators with their respective weights. However, contracting authorities in Bulgaria rarely provide any written argument or statement to explain the assessment of the various components of the bid and the ranking. Thus the scores by individual criteria can be manipulated and adjusted to a desired final ranking. It is possible to do so because the individual components are not assessed and announced independently from one another, and also because the final assessment is not the result of independent expert appraisal.

<sup>13</sup> BIA Public Procurement Monitoring: The Most Common Violations and Corrupt Practices, Sofia, p. 18



**Lack of full transparency in the announcement of the bids and the ranking.** The lack of transparency with regard to the parameters of the bids in tender procedures creates opportunities for further adjustment and improvement of certain bids before the final ranking is announced. Such a blackout is a condition and invitation to resort to corrupt manipulation of the tender procedure.

**Other barriers to participation in public procurement.** Sometimes the costs for participation in the tenders are artificially inflated to discourage 'accidental' players. Although the Bulgarian law does allow the price of the tender documentation to exceed its production cost, in most cases it resembles more a participation fee rather than a charge to cover actual costs. In some cases it is excessive and functions as a filter at the input stage of the tender procedure. Similar barriers are also the unrealistically short deadlines for the submission of bids which can only be met only by companies which have been tipped off in advance. This corrupt practice is related to the leakage of information about the terms of reference for the benefit of a preferred supplier.

**Cancellation or discontinuation of tender procedures.** Lastly, if all these measures cannot ensure the victory of the preferred supplier, the contracting authority might terminate the procedure, citing as excuses either lack of financing or discrepancies between the bids and the terms of reference. In most cases, there are no clear arguments to support such decisions and outsiders are left only with the costs of bidding in the tender procedure and with a general feeling of distrust in the official rules of the game. Such negative experiences from the participation in irregular procedures act to restrict competition and expand further the range of companies prepared to pay bribes in public procurement procedures.

All the above corrupt practices employed in Bulgaria are related to the directing and awarding of a contract to a preferred supplier ensuring personal benefits for the public officials representing the contracting authorities. They cover the stages of the preparation of the tender documentation and the ranking of the bidders in accordance with the announced criteria. But corruption in the public procurement sphere does not end there. The stage of the implementation of public procurement contracts is not protected against the risk of abuse and corrupt practices either.

**Limited opportunities for appeal.** In some cases, the contracting authorities do not advise the failed bidders in due course which deprives them of legal remedy within the time limits prescribed by law.

**Implementation of the contract.** The most widely spread corrupt practice at the implementation stage of public procurement in Bulgaria is the renegotiation of the qualitative parameters of the contract or their outright neglect, or even the change in the price terms. Thus, the contractor who has paid a bribe is able to offer much higher quality at a lower price in the bid, knowing that these bidding parameters are intended only to beat the competition and can be changed during the implementation phase. Indeed, the amendments to the Law on Public Procurement of 2004 tried to put effective barriers to the common practice of signing annexes to the contracts intended to change the initial terms of the public procurement contract. But, at the same time, the law does not include any provisions to ensure control over the implementation of the contract in accordance with the terms and

conditions of the tender. In fact, the LPP regulates the process until the signing of the contract. If there are no changes to the contract, the control over its implementation is left beyond the scope of the law.

From the viewpoint of the size of the transactions, the data of the internal audits show that the corruption risk increases in line with the size of the public procurement value. This is no surprise: large-scale corruption occurs where there is a lot of money involved. Nevertheless, the public debate on this issue was focused for quite some time on the thresholds set out in the LPP and the negative effect of their increase on the corruption risk. Most of the internal audit resources were also allocated in this area. Out of the 2,551 violations established in 2005, 1,900 were in the category of small-scale procurement but their total value was 51.7 million levs, i.e. 9% of the total value of uncovered irregular procedures. This distribution of the risk comes to support the suggestion that, from the viewpoint of the efficiency of control and business costs in the supply of goods and services to the public sector, it is better to raise the public procurement thresholds and to allocate the available administrative resources for the enforcement of the law on the biggest transactions. The optimal internal audit coverage target could be the transactions which constitute 60% to 70% of the value of all procurement contracts signed. At present, the share of the audited procedures is some 30% to 35% in value terms. The data from the internal audit report show that the emphasis is on small-scale procurement, i.e. the lower levels of government.

### 3. THE ENERGY SECTOR – A SECTOR OF HIGH CORRUPTION RISK

#### 3.1. SOURCES OF CORRUPTION RISK

The energy sector is among the most important industries in the national economy with a major share in the industrial added value.<sup>14</sup> According to the data of the Ministry of the Economy and Energy,<sup>15</sup> the generation of electricity in 2005 reached approximately the 1988 level, when it was 45,000 GWh annually. Currently, it is about 44,000 GWh annually. While taking into account the technical and commercial losses, some 27,000 GWh out of this quantity are hypothetically sold at a value exceeding 2 billion levs net of the VAT. Besides, there is the added value in the other energy sub-sectors, such as the production of and trade in coal and other solid fuels, gas and heating, the extraction of oil and natural gas, and the management of water energy resources.

At least a half of the companies with the largest sales in this country operate in the energy sector.<sup>16</sup> Over the recent years, the National Electricity Company (NEC) and Bulgargas have traditionally topped the ranking, while the Sofia City Electric Distribution Company, Maritsa-East 2 TPP and others have been in the top ten. However, they do not occupy leading positions in terms of investment efficiency. The profit of producers and distributors of electricity decreases over time, whereas the contractors implementing public procurement contracts awarded by the biggest energy companies are considered to be some of the most profitable businesses in the country. For instance, the Bulgarian Chamber of Commerce and Industry ranking in 2004 showed that the National Electricity Company was number one in sales but its profit was less than 1 %. NEC ranked 88th in terms of the return on investment with its assets worth 3.17 billion levs. Kozlodui NPP ranked fourth in terms of its gross sales reaching close to 645 million levs but its profitability continued to lag behind. Maritsa-East 2 TPP occupied the eighth place in the BCCI ranking with its revenues of almost 305 million levs but in terms of profitability it ranked as low as 59th. In 2005, the financial condition of large producers did not improve: NEC reported book profit of only 66.8 million levs, Kozlodui NPP was already loss-generating, and electric distribution companies reported minimal profits.

In the face of the shrinking profits of monopoly producers that, over the period 2003 – 2004, Risk Engineering was the company with the third

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<sup>14</sup> The gross added value of the country was reported by the NSI to be slightly over 36 billion levs in 2005, out of which industry accounted for some 11 billion levs (26.1%). See [www.nsi.bg/gdp/](http://www.nsi.bg/gdp/)

<sup>15</sup> See <http://www.seerecon.org/infrastructure/sectors/energy/> and V. Anastasov's presentation "Electricity Consumption Forecasts" at the round table discussion Bulgaria's Energy Sector – What's Next? Held by the MEE and the World Energy Council on 20 March 2006.

<sup>16</sup> According to the ranking of the Top 10 Companies 2005 in terms of sales revenues announced by the Bulgarian Chamber of Commerce and Industry.

largest sales and, at the same time, it was awarded the largest public procurement contract for repair works of the facilities at Kozlodui NPP. Moreover, Risk Engineering ranked first in terms of return on investment (profit per 100 levs of assets) and second in terms of profitability. It would be interesting to compare the growth of the sales and profitability of the NEC intermediary companies in the exports of electricity. It cannot be done, however, due to the restricted access to information. The great turnovers in the context of the major intervention of the government and the lack of competitive environment expose the sector to substantial corruption risks. In 2004, the then Ministry of Energy and Energy Resources (MEER) admitted that the corruption risk “remained high” in that sector due to:

- the insufficient legal regulation at the national and institutional levels on the status and functions of the specialized anti-corruption structure at the MEER;
- the large stakes and the substantial financial resources in the energy sector;
- the process of privatization of the electric distribution companies;
- the large investment projects in terms of both number and value;
- the pressing need for strengthening of the capacity of inspectorates;
- the need for introduction of a training system for the people involved in the combat against corruption;
- the need for development of a policy to increase salaries as a factor for the reduction of the corruption risk.<sup>17</sup>

But those observations did not bring about any real practical measures. Moreover, there are many signs of the growing level of corruption in the energy sector. One of them is the increased share of the exported electricity by private intermediaries rather than by NEC. In the opinion of the former Member of Parliament Mr. Lambovski, bribes in the energy sector amount to some 10 million levs on a monthly basis. Besides, the corruption potential in the sector is used very skillfully and intensely under the guise of claims that the highest political and national interests are protected in this way. What are the reasons and conditions for this situation?

**First**, the energy sector suffers from lack of competition and from inefficient government regulation, both of **which create conditions that incur excessive costs at the expense of consumers**. They generate considerable corruption resources and opportunities for their distribution opposite to the logic of the market.

Energy activities are heavily regulated. The Law on Energy defines a wide range of activities subject to regulation: generation, imports and exports, transmission, transit transmission, distribution of electricity and heating, natural gas, oil and oil

<sup>17</sup> *The Energy Sector Has a Huge Kick-back Potential*, The Monitor daily, 21 December 2004.

products, trade in electricity and heating and natural gas, and use of renewable energy sources. However, the regulatory body, the State Energy and Water Regulatory Commission (SEWRC), is not protected against the pressures which those managing the sector might exert in pursuit of personal interests. This is partly due to the closed circle of energy experts and also to the huge financial stakes. Since there are no opportunities to seek collective (group) remedies, citizens are discouraged to withstand their rights before SEWRC because the personal interest of individuals has too low individual value compared to the legal defence costs.

SEWRC is required by law to control electricity producers and distributors so that to prevent them from using their monopoly position on the market to the detriment of consumers. But it seems that the price control is focused primarily on the electric distribution companies. However, distribution is only the final stage in the whole chain. In fact, in a monopoly environment distributors are expected to take up the protection of the end consumers without any opportunities to influence the other participants upstream all the way to the producers and the importers of energy sources. Thus the regulatory control of electricity producers remains very limited. They are shielded by their principal and the discontent of consumers can easily be re-directed to the suppliers which often operate even under the acceptable standards of service, although they have been privatized. But the law requires comprehensive auditing of the way in which producers form their prices at which they sell to the distributors (electric distribution companies or EDCs).

A formal procedure does exist. The business plans of producer companies are examined and approved by SEWRC. They can well envisage excessive expenditure that nobody would control because of the lack of capacity at the regulatory authority and sometimes also because of the inability of the companies themselves to draw up business plans. No precise economic analysis is carried out to check the way in which companies are managed or the practical need for one or another kind of expenditures and mainly the efficiency of the investment policies calculated in prices per unit of capacity and compared to the average European efficiency benchmarks.

The management of NEC and Kozlodui NPP use all kinds of pretexts to warn that the price of electricity would be increased soon. Last year, for example, NEC made forecasts that the price of electricity would grow by 30 % upon the closing down of units 3 and 4 of Kozlodui NPP. The estimates of Ms. Dilovska, who was Deputy Minister of Energy at the time, pointed to an expected price increase by some 3 %. Later on, NEC came out with new arguments, claiming that because of the coal price increase the price of electricity had to go up by 15 % in July 2006. But the real share of coal in the prime cost of electricity revealed that such an increase of the price of electricity would correspond to soaring of coal prices by 50 to 60 percent, which was far from reality. The growing speculations with the estimated costs for the maintenance of de-commissioned nuclear reactors have a similar purpose. But the annual reports of Kozlodui NPP outline a different picture of the costs needed to maintain operating reactors. About 30 % of the costs go for nuclear fuel. 18 % of the sales revenues are remitted to the special funds. Depreciation costs account for some 23 %. They discontinue when reactors are

closed down. Another 15 % are labour costs and 16 % are operational costs and they should be greatly reduced after the decommissioning of the units.

Such speculations are intended to justify the demands for increases in the electricity price. Given the lack of economic and financial grounds, many experts are of the opinion that such demands reflect corrupt interests. Ultimately, this has led to a situation in which the prices of electricity for individuals and businesses are higher in Bulgaria than in many European countries.<sup>18</sup>

**Second, the sector is strongly dependent on the energy sources supplied under monopoly import terms and conditions.** The local entities enjoying the trust and confidence of energy suppliers actually dominate the domestic market. It is not difficult for them to create the impression that there is no alternative to their involvement in the transactions. Since the energy imports depend on many geopolitical factors, one can assert that the energy market is characterized by strong political influences and it is a field of conflicts among divergent economic interests. This has a peculiar impact on the domestic energy market. Political and economic circles take shape in close connection with countries producing energy sources and with corporate structures dominating in them. Their success results from the penetration into the highest political circles over time, regardless of their political affiliation, on the one hand, and on the other, on their connections to the external energy suppliers who are typically linked to the highest political circles in their own countries. It is at this level that the influence of the business environment structured in this particular way is exerted on the energy security in the country and the region. Thus, the importation of energy sources becomes a serious channel for political influence coming from outside. Besides, the monopoly position of importers gives them the opportunity to apply prices exceeding those of the international markets.

Quite indicative in this respect is the importation of nuclear fuel for Kozlodui NPP. Each year one-third of the fuel in the reactors is to be replaced. Units 5 and 6 of the power plant need some 55 tons of fresh fuel on an annual basis. The only producer of nuclear fuel for this type of reactors is Russia. Furthermore, nuclear fuel is imported through intermediaries and the contract was amended to the detriment of the Bulgarian side a few years ago. As a result, the nuclear power plant purchases the Russian fuel at a price which is about 22 % higher than that of the international markets.<sup>19</sup> Besides, the Russian nuclear fuel is known to be of poorer quality than the fuel offered by Western producers. However, that was not an obstacle for the nuclear power plant which signed a supply agreement valid until 2020.

**Third, the issue of the export of electricity** is similar, although with a reverse logic. Here again, intermediaries are involved and the professional community believes that there is no way to avoid them.

<sup>18</sup> See the interview of Commissioner Andris Piebalgs to the Macedonian newspaper Dnevnik published in November 2005, where he wondered how people in the Balkan countries managed to pay their electricity bills because electricity prices were often higher than those in the EU countries.

<sup>19</sup> *Banker weekly*, No. 23, 10 – 16 June 2006.



### Box 1. Export of electricity

NEC carries out the transmission, import and export of electricity and the traditional export markets are the countries on the Balkan Peninsula. For the last few years, this most profitable activity has been in the hands of private traders in electricity. In 2003, the annual report of NEC pointed to exports of 5.45 billion kWh but did not specify the percentage of exports through intermediaries. In 2005, exports amounted to 7.6 billion kWh (2005 Annual Report of NEC) and the share of intermediaries was not specified. At its meeting held on 29 June 2006, the Parliamentary Anti-corruption Committee examined a NEC letter which made it clear that 90 % of the exports in 2005 were carried out through intermediaries. The names of the private exporters were not mentioned and NEC explained their involvement with the willingness of the electric companies in the neighbouring countries to work with intermediaries and also with the claim that NEC could not afford deferred payments for 60 days and therefore it could not win in public tenders. The NEC annual reports make it clear that the revenues of NEC from exports were 3.1 eurocents per kWh on the average. On 30 November 2006, Focus Agency quoted the Macedonian daily Dnevnik which reported the following: "The bidders in the public tender for importation of electricity offered to supply only a half of the quantity of electricity that Macedonia needs. The Macedonian electric transmission system operator (MEPCO) wants to purchase 0.862 billion kWh to meet the needs of the country until the end of April 2007. The lowest bid quoted 5.6 eurocents per kWh in April and 8.98 eurocents per kWh in the winter months." Obviously the price differential is at least 0.5 eurocents per kWh and it may well reach over 6 eurocents in the winter months. Even in "the worst scenario" from the perspective of intermediaries, the difference would amount to some € 35 million or close to 70 million leva. These are the revenues which NEC gives up (although they are bigger than the profit reported in 2005) and leaves them to intermediaries.

However, it should be noted that actually NEC carried out the export of electricity on its own several years ago. The practice of a widespread use of intermediaries has become quite common for the last few years. NEC officially announced that exports were carried out mainly through intermediaries for the first time in its 2004 annual report, which read that "the quantity of the electricity exported in 2004 through traders in electric power accounted for 81.3 % of the total exports". In 2005, almost 90 % of the exports passed through intermediaries. There exist no economic justifications for this situation because, in practice, NEC holds the monopoly on the purchase of electricity for export purposes; it has full monopoly over the high-voltage network that is used to bring the electricity to the neighbouring countries to which the exports are almost exclusively oriented.

In general, intermediaries in the export of electricity belong to the same business circles which control the importation of energy sources. This has become possible because the export of electricity is launched in public as a strategic business project of Bulgaria. Many economic analyses prove that the prospects might not be so bright for this type of exports since the exports comply with a standard in shrinking demand.

Besides, the size of the NEC revenues from exports is far below the levels of a strategic national priority. In 2004, for instance, exports accounted for 17.2 % of the electricity generated and provided 18.2 % of the revenues.<sup>20</sup> Had it been true that NEC made a large profit from the export of electricity, exports would have generated, say, 30 - 40 % of the revenues. The NEC annual reports for 2004 and 2005 reveal that the average export price per kWh of NEC was less than 0.1 eurocent

<sup>20</sup> See 2004 Annual Report of NEC.

above the price on the domestic market, in spite of the much higher price on the international market. Undoubtedly, such practices are harmful to the state-owned enterprise, to the government budget and to the consumers but they are beneficial to the intermediaries.

The need for intermediaries is justified in various ways but, most frequently, it is done as a result of their greater flexibility and ability to adapt more easily to the market requirements in comparison to NEC. For instance, intermediaries claim to be capable of offering deferred payment of 60 days for the supply of electricity to their customers, while NEC is believed to be unable to do so. If there was an export contract though, any commercial bank would be prepared to lend to NEC. The argument that the use of intermediaries contribute to the market liberalization process is similar. It is claimed further that “companies in the neighbouring countries are willing to work with intermediaries”.<sup>21</sup> However, it is perfectly clear that if NEC were a private company, it would not allow any single kWh to be exported by a competitor.

**Fourth**, the sector is characterized by **high technical and environmental risks and it affects the national security**. All this naturally supports the arguments about restricting the access to information and to the debates on technological issues. In many cases, it is possible for information to be concealed without any sanction through its unjustified classification. This is particularly relevant to nuclear energy. The *Law on the Safe Use of Nuclear Energy* puts safety on top of the agenda for understandable reasons. Article 3, para 2 reads that “in the use of nuclear energy and ionizing radiation and in the radioactive waste management nuclear safety and radiation protection shall have priority over any other aspect of these activities”. This creates a substantial loophole for awarding public procurement contracts without any competition or even without any formal procedure. Thus, all other aspects of the public interest can be sacrificed in the name of safety without sanctions, including such aspects as cost efficiency, openness, transparency, competition and etiquette. The reference to safety has turned into a mantra in the nuclear energy sector which is not subject to discussion. It turns out that the legal provisions quoted above become the universal excuse for the violation or neglect of other laws or rules of ethics.

The high public and international sensitivity to nuclear safety issues turns into justification for the frequent and sometimes uncontrolled increase of the costs of Kozlodui NPP. The data from the annual reports of the nuclear power plant show that the prime cost was 0.034 levs per kWh in 2001. In 2002 (prior to the closing down of Units 1 and 2), it increased by as much as 15 %. The same rate was reported in 2003, reaching 0.044 levs. Throughout the period there was no increase of the prices of metals or nuclear energy, the exchange rate of the U.S. dollar dropped substantially, the facilities at the nuclear power plant were better

<sup>21</sup> See Minutes from the meeting of the Parliamentary Anti-corruption Committee, 29 June 2006. A representative of NEC justified the need for intermediaries in the following way: “When state-owned companies in the neighbouring countries, to which we exported about 10 %, and these are the companies of Macedonia, Serbia, Greece, Kosovo and Croatia, are no longer willing to buy, I want to ask whether the remaining 90 % of the output generated by our facilities should stay like monuments or their output should be sold somewhere”.



utilized and staffing levels were reduced. Nevertheless, the prices of nuclear energy continued to grow in Bulgaria. The only plausible explanation could be investments in safety, although EU grants worth millions were allocated for that purpose. The comparison to the financial performance of nuclear power plants of the same type in market economies points to inefficiency of the generation of nuclear power instead. The operational costs of U.S. nuclear power plants were about \$ 0.016 per kWh on a net basis in 2004. The operational costs of French nuclear power plants were even lower. The adjustment to identical terms reveals that the operational costs of Kozlodui NPP were approximately 40 % higher than those of U.S. nuclear power plants. Such large discrepancies could hardly be explained by economic arguments because the costs incurred for nuclear fuel, materials, spare parts and others in the nuclear energy sector are at international prices and few of them are specific.

**The energy experts** in Bulgaria are not that many and they could hardly be called independent. Almost all of them are employed in the sector or provide consultancy services to it. The need for adequate expertise makes the participation of the non-governmental sector and the general public in the public debate very difficult, especially when the issue at stake is the making of crucial decisions with far-reaching consequences. In fact, civil society is allowed to take part in the discussion of only two sets of issues: the protection of the environment and the expediency of the closing down of the first units of Kozoldui NPP. This situation is also made worse by the underdeveloped consumer protection mechanisms and the lack of legal remedies against decisions of great importance to society. The expert parlance and the closed nature of the system make it difficult for external institutions to exercise control and to prove the liability in formal court proceedings. Any attempt at proving some violation would inevitably grow into a technical debate on the expediency of one or another decision. The bodies which administer justice would practically be unable to find independent and unbiased experts capable to justify it.

All this is particularly relevant to **experts in the nuclear sector**. They enjoy relatively high trust and confidence by the general public. The debate on the closing down of Units 3 and 4 of Kozlodui NPP and the construction of Belene NPP was actually diverted from economic expediency and channelled into abstract national interest deliberations. The arguments that were put forward sought to appeal to infringed national pride or a professed concern about higher prices hurting the consumer. The discussion on the price of the electricity generated by the nuclear power plant held at the expert level was not reported in the media in a way that could be comprehensible to consumers. Thus the arguments that nuclear energy was not the cheapest one and it could even prove to be the most expensive, taking into consideration most of the decommissioning costs and other price-formative factors, including the price of attracted financial resources over time, did not reach the public. Technically, this process has been going on for decades; the personnel of the nuclear power plant is numerous and the nuclear waste is not stored or disposed of free of charge. Both the public opinion and the media were not impressed by the disclosed data or the lack of explanation of the depreciation allowances at the nuclear power plant or the continuous growth of the investment in facilities

subject to closure or the lack of clear explanations of the exact price of the electricity generated there.<sup>22</sup>

**Finally, whether privatization could be a solution to these risks is a key issue.**

Privatization *per se* cannot resolve efficiency problems against a non-existing market competition, particularly given the public mistrust in its transparency. Still, what makes corrupt practices in the privatization of the energy sector different from those in the other sectors of the economy? Given that a sizeable portion of the market is monopolized, it is not so much a matter of corruption in the privatization process but an opportunity for corrupt practices in the private monopoly under inefficient state regulation. A large percentage of potential buyers with predominant or exclusive government stake (although some state-owned enterprises are public) is typical for the energy sector. In fact, the old schemes of government officials draining resources out of the energy enterprises are being replaced by schemes to be applied by foreign officials. If the main objectives of the privatization are to promote the market and enhance efficiency through the involvement of the private sector, this legislative approach should be defined as inadequate, to say the least. The ‘novelty’ is that the same companies that controlled both the input and the output of state enterprises are still involved but now as intermediaries in the import and export of raw materials and electricity. Their earlier incarnation as consultants in the privatization process was substituted by them being import or export intermediaries. The reason for this adaptation is related to their continued influence in SEWRC and MEE.

An indirect indicator of the quality of buyers is the price offered for the facilities to be privatized. In the course of the 15-year-long history of the Bulgarian privatization, there have been no other cases when packages of shares had price quotation differences of dozens of times at the same point of time. This could mean that either the buyers count on fundamentally different development strategies for the privatized company and, as a result, bids differ as much as 1:30 or more, or that they have no clear idea of the management of a private company or that unequal treatment is involved and some bidders have more information at their disposal than others. The problem is that the Law on the Privatization and the Post-privatization control does not allow participation of Bulgarian buyers with predominant state or municipal stake but it allows participation of buyers with predominant state interest from other countries. It is no surprise that the only facilities suitable for privatization and for attracting foreign investment have turned out to be the several larger electric distribution companies. Of course, their attitude to businesses and consumers cannot be substantially different from that of the state-owned companies. They turned to be the convenient culprits for the growing electricity prices and the energy shortages which have occurred in some regions. Thus they unwittingly became a convenient excuse for the excessive expenditures in the power plants and in the transmission phase at the expense of the consumers. The ongoing privatization process continues to turn into a clash between domestic

<sup>22</sup> The price should be the sum total of two components – one for the facilities and one for the generation of electricity. It should be identical to the electricity purchase price but this is not the case in reality and there are no satisfactory explanations to this effect.

and foreign capital, where foreign interests are sometimes represented by state-owned enterprises (including a publicly quoted one), whereas domestic capital does not enjoy the trust and confidence of the general public. The only exceptions are the several electric distribution and district heating companies. On the other hand, since NEC and Bulgargas are on the list of companies that are not to be privatized for years to come, the attempts to privatize certain elements of their operations - such as the exports of electricity in the case of NEC – are of increasing interest.

In this context, an issue of considerable public interest is whether privatization is appropriate if it only leads only to the replacement of domestic corrupt practices by foreign ones beyond the jurisdiction of the Bulgarian state and often also beyond that of the European Union. This also sets international anti-corruption efforts in an entirely new context. It is perfectly possible for the management of a Bulgarian enterprise to be involved in foreign corrupt schemes but affecting mainly and only the interests of Bulgarian consumers. The simplest case is the public procurement at a local enterprise, where corruption takes place abroad and hence the Bulgarian law enforcement authorities are unable to prevent or prosecute it. One of the possible illustrations refers primarily to the public procurement of imported energy sources.

### 3.2. PUBLIC PROCUREMENT IN THE ENERGY SECTOR

The energy sector has always made huge investments in comparison to the other sectors of the economy, regardless of the economic condition of the country. According to a survey of the Bulgarian Energy Chamber, energy enterprises have planned investments of 1,178 million leva which is 150 % more than the level in 2006 (Table 4).

**Table 4. Growth of investments in the energy sector 2006 – 2007 (mln leva)**

	2006	2007
Kozlodui NPP	82	100
NEC	243	412
Generation of electricity	197	357
Distribution of electricity	200	280
District heating companies	52	29
Total	774	1,178

Source: Bulgarian Energy Chamber.

The general public does not always have access to information about the need for and the expected effect from these investments. In some cases, they are necessary and justified in terms of their type but not in terms of their amount.

Currently, for instance, the harmonization with the EU environmental protection standards is underway. Even the most conservative estimates point to hundreds of millions of Euros. The adjustment involves the construction of desulphurization systems in all thermal power plants and this measure enjoys sufficient public approval. However, there is always the risk even for the most appropriate measures to create favorable conditions for abuse so that to substantially exceed the real expenditures needed. Energy investment projects are typically quite expensive. Their average price is many times higher than that in the other sectors. The value of an ordinary turbine, for example, is equal to at least the value of several new hotels at the Black Sea coast, together with the value of the land, the equipment and the furniture. It is easy to conceal corrupt payments in such projects which most frequently go through the ubiquitous consultants. The value and nature of these projects inevitably call for the involvement of an engineer consultant who exercises a number of delegated state control functions as prescribed by law.

It is only natural for these large investments in the sector to have at least three energy companies ranking among the largest contracting authorities under the LPP and RSPP. According to the data from the Public Procurement Agency, in terms of the value of the public procurement contracts awarded over the period from 2004 and 2006, those were NEC EAD; Maritsa-East Mines EAD, Radnevo; Maritsa-East 2 TPP, and Kozoldui NPP (*Appendix 1*). These four companies have awarded contracts worth more than 8.5 billion levs for the last three years, accounting for 77% of the total value of the public procurement contracts awarded by the top ten contracting authorities for the same period. Since, according to the same data, about two-thirds (66.5%) of the total value of public procurement are contracted by sectoral contracting authorities, it can be concluded that **energy companies have structural significance for the public procurement sector and they have appropriate feedback mechanisms to influence the market of certain supplies, services and construction works**. Besides, one should remember that the available data refer only to the public procurement contracts awarded under the LPP and RSPP. The law provides for the option to award contracts without holding public procurement procedures under certain thresholds.

**Table 5. Number and value of public procurement contracts in the energy sector (1 October 2004 – 30 June 2006) (levs)**

Total for the period 1 October 2004 – 30 June 2006	Number of tenders announced	Number of contracts awarded	Value of the contracts awarded
Total	2,139	2,239	9,078,854,031
Construction works	328	320	8,165,029,124
Supplies	1,055	1,112	520,043,553
Services	756	807	393,781,353

Source: PPA.

The risk of awarding **unfavorable public procurement contracts** is higher in the energy sector than elsewhere. The reasons lie in the existing monopoly over the distribution of electricity, heating and gas; the special market and PR significance of nuclear energy; the greater technical risks and the priority of nuclear safety over all other operational, legal and economic aspects (Art. 3, para 2 *Law on the Safe Use of Nuclear Energy*); the closed and non-transparent price formation and approval and regulation of the sector as a whole; the large scale of the main producers, etc. The sector does not have the practice of calculating the effect of some public procurement or technical project on the basis of the end result. Generally, the application of formal criteria to the technical specifications leads, deliberately or not, to unfavorable end results. Investments are rarely evaluated, while taking into account the full range of efficiency criteria in the energy sector: the value per unit of output capacity for the whole period of operation of the facilities plus the reliability of the equipment (actually, the full life cycle). For instance, when nuclear fuel is supplied, the price is calculated on the basis of metric units rather than the quantity of energy they can generate.

#### **Box 2. Supply of nuclear fuel for Kozlodui NPP**

Kozoldui NPP conducted a public procurement tender for the supply of nuclear fuel. That happened in a more or less competitive environment and it was possible to reach a favorable price. The contract was awarded to the Russian company Tver which offered fuel of the lowest technical category at a price which was 20 % higher than the international price. That became possible because of the way in which the technical specifications were formulated in the public tender. The price bids were calculated and compared in terms of the quantity of fuel supplied rather than the quantity of energy it could generate.

Source: See Verbatim Report – Minutes No. 31 of 29 June 2006 of the Parliamentary Anti-corruption Committee and the sources quoted there.

Experts are of the opinion that in the case of many investment projects in the energy sector the price per 1 MW of installed or rehabilitated capacity is much higher than the price in similar or more developed countries. Unless the opposite is convincingly justified and supported by official numbers, this would be a clear sign of the amount of public resources abused. In such cases, society suffers

double damage: taxpayers pay these amounts through overt or covert forms of state subsidies or guarantees in the form of government commitments to provide support and cover costs and then all electricity consumers pay once again. The appraisal of projects on the basis of price/capacity/duration/environmental effects/costs is not applied to the process of making decisions of great importance for the national economy. The competition among potential partners, suppliers or contractors is thus even less encouraged.

### 3.3. FORMS OF ABUSE

Several main types of deviation from the rules of ethics and economic expediency can be discerned in the public procurement in the energy sector. Some of them can be defined also as unlawful, while others formally comply with the letter of the law but they lead to damage which is compensated by distributing the loss among consumers. The main types of violations and deviations in the public procurement in the energy sector are as follows:

- opening of public procurement procedures which are not expedient (do not meet public needs) in order to spend resources or to ensure personal benefit;
- selection of negotiations regardless of the options to hold a more competitive procedure and/or a non-professional team;
- deliberate manipulation of the procedure and the related documentation, including its unnecessary complications or ambiguities;
- deliberate manipulation of the requirements to the bidders; inadequate qualification criteria, requirements for experience, certification and technical requirements;
- exertion of administrative or political pressure to hire certain subcontractors or to guide the decisions of the administrative staff of the contracting authority;

#### Box 3. Supply of equipment for Maritsa-East 2 TPP

In 1998, Maritsa-East 2 TPP announced a public procurement procedure for the supply and installation of a turbine. The selection was carried out at NEC EAD by a committee appointed by the Board of Directors of NEC. The appointment was confirmed by a decision of the Board of Directors of the company because, at that time, Maritsa-East 2 TPP was a branch of NEC. The principal gave its approval. The winner offered experimental equipment without the necessary guarantees. The purchased turbine could not be set into operation in the course of several years after its supply and installation. As a result of that inaction of the company, huge damage was caused due to the failure to generate power. The contractor could not be made to compensate for the damage since the contract did not contain such clauses. The only option left was to seek remedy pursuant to the general provisions for compensation under Art. 45 of the *Law on Obligations and Contracts*, requiring proof of the amount of the damage incurred. There is no available evidence to prove that it was done and, meanwhile, the statute of limitation for that damage expired.

Source: *Pari Daily*, 27 October 2004.



- exertion of pressure on the contractor through the procedure for payments;
- deliberate creation of unequal treatment or prerequisites for inequality or unfair competition among the bidders;
- breach of trust and disclosure of information.<sup>23</sup>

Some typical violations are related to the decision to hold and announce procedures.<sup>24</sup> The others involve deliberate errors in the opening of the procedure so that to provide grounds for its discontinuation if the best bid comes from an “unwelcome” candidate. In such cases, it is found out before the end of the procedure that financial resources are unavailable. These procedural maneuvers can continue until the favored bidder wins.

#### **Box 4. The Modernization of Kozoldui NPP**

In 1998, a contract was concluded in connection with the modernization of Units 5 and 6 of Kozoldui NPP. The initial price of the contract was \$8 million (which increased subsequently to \$24 million by 2004, which was indicative of the problem with the efficiency of public procurement and the justification of the costs). The contract was signed with a company which was registered specifically for that purpose and no public tender was held. Furthermore, the subcontractors would also to be selected on a non-competitive basis, regardless of the high price of the project and the enhanced public interest. It was perfectly lawful because the documentation did not envisage such a requirement. The issue of the modernization costs for Units 3 and 4 of Kozlodui NPP after the agreement between the Government of Bulgaria and the EU on their closing down was discussed also by the Parliamentary Anti-corruption Committee. According to the information made available there, the post-2001 costs for the two units amounted to some \$180 million and they would continue until 2009. The problem would have hardly reached the Bulgarian general public without the inquiry of the European Commission into the modernization programs and the residual resource management programs until 2009.

Source: Minutes No. 31 of 29 June 2006 of the meeting of the Committee; Capital weekly, No. 45 of 2006

<sup>23</sup> Relations of trust often occur in the public procurement sphere on the basis of information protected by law. The excessive expansion or restriction of the requirements to the documentation in this connection could lead to abuse to the detriment of the contractor.

<sup>24</sup> Just a short excerpt from the catalogue: wording of the subject-matter of the procedure in a misleading way or in a way which does not fully correspond to the nature of the public procurement; establishment of unjustified or obscure criteria related to the qualifications; introduction of requirements for experience in spheres of little practical relevance; requirements for experience on a scale which is obviously irrelevant to the volume and nature of the contract; requirements for certification under a less known certification scheme (prior to the amendments to Arts. 30 to 33 LPP); excessively long validity term of the bids against the backdrop of dynamic market developments; too stringent technical requirements based on the catalogue of a certain manufacturer or bidder; excessively high and stringent requirements to the qualifications of the staff; too complicated procedure for obtaining the documentation; explanations on the content of the documentation, when the answers obviously do not cover the questions or come just before the deadline for the submission of the bids when essential aspects are clarified; unduly complicated or obscure procedure for submission of the bids, etc. Non-governmental organizations have gathered information on some of these practices.

The evasion of a competitive public procurement procedure has a long history. A typical example under the earlier versions of the LPP was the awarding of contracts for services labeled as R&D. That has become much more difficult under the latest version of the law. Still, the specific features of the energy sector facilitate the evasion of compliance. The factors which contribute to this situation are as follows: the above mentioned Art. 3, para 2 of the *Law on the Safe Use of Nuclear Energy*; the technological monopoly over many supplies (e.g. nuclear fuel or spare parts); the electricity export arrangements, and so on.

The tendency for less competitive public procurement procedures in the energy sector can be seen in the relatively high percentage - about 40 % of all procedures - of negotiations with or without announcement (*Table 6*).

#### Box 5. Belene NPP

The Council of Ministers adopted a decision dated 29 April 2004 to approve the report of the Minister of Energy and Energy Resources on the construction of a nuclear power plant in Belene and to instruct the relevant ministers to hold negotiations with the potential investors and financial institutions to sign the project implementation contracts. The type of procedure chosen - even leaving aside the problems with the expediency of such a project started without any public debate - was a case in point. No explanations were given as to why the biggest ever public procurement in Bulgaria (7.82 billion leva) would be awarded through the non-competitive procedure of negotiations. Thus the Ministry of the Environment and Waters approved the construction of a 2,000 MW facility on the basis of the light water technology. It provided opportunities for broadening the scope of potential bidders. At the same time, however, NEC announced a procedure only for Russian reactors of the WWER type, excluding the Western light-water type of reactors. That was a typical case of manipulated public procurement documentation and the technical specifications in particular to the benefit of a certain bidder or certain bidders. But the most important thing was the restriction of competition.

The government institutions rejected those arguments and stated that the documentation did not mention Russian reactors and that the equipment already supplied on the site of Belene was manufactured by Skoda, the Czech Republic. A public tender was announced for the completion of units 1 and the construction of unit 2 on the basis of the light-water technology. Theoretically, at least four manufacturers could participate. The procedure offered three options: bids for the whole plant or separately for the nuclear and non-nuclear part and another one for the fuel. Still, the only bidders were two companies producing WWER type reactors only. Following the selection of the foretold winner the NEC stated that for security and economic reasons it had been decided to construct entirely new units rather than the completion of the first two. These considerations had been, however, pointed out by experts two years earlier and they should have led to a tender for all types of light water reactors not only WWER.

*Table 6* makes it clear that 51.3 % of all public procurement procedures in the energy sector involved negotiations with or without announcement under the LPP, including accelerated procedures, and invitations under the RSPP. If contracts concluded without any public procurement procedure are added it becomes clear that the erosion of market competition is the rule rather than the exception. This conclusion is supported also by the use of the commodity exchange trading by the sectoral contracting authorities. Most of the public procurement contracts in the energy sector are supplies of energy sources. They can easily be purchased on the commodity exchanges in Bulgaria and abroad. It seems, however, that this procedure is assiduously avoided, in spite of the detailed regulation set out in the



LPP Implementing Rules which leave no grounds for doubt as to their lawfulness. According to the data from the Public Procurement Agency, the number of public procurement procedures in the energy sector through commodity exchange transactions was 16 out of a total of 2,139 over the period from 1 October 2004 to 30 June 2006, i.e. they accounted for only 0.7%. One of the reasons is perhaps the limited corruption potential of commodity exchange transactions due to the lack of direct contact between the buyer and the supplied in the course of the negotiations.

**Table 6. Public procurement in the energy sector by types of procedures (October 2004 – June 2006)**

	2004	2005	2006	Total	Share (%)
Number of public procurement procedures, including:	138	1,220	781	2,139	100
Open procedures under the LPP	48	268	151	467	21.8
Restricted procedures under the LPP	0	3	3	6	0.3
Accelerated restricted procedures under the LPP	0	0	0	0	0
<b>Negotiations with announcement under the LPP</b>	<b>15</b>	<b>282</b>	<b>225</b>	<b>522</b>	<b>24.4</b>
Accelerated negotiations with announcement under the LPP	3	12	2	17	0.8
<b>Negotiations without announcement under the LPP</b>	<b>14</b>	<b>191</b>	<b>114</b>	<b>319</b>	<b>14.9</b>
Open competitive bidding under the RSPP	43	269	175	487	22.8
Public tender under the RSPP	0	2	2	4	0.2
Negotiations by invitation under the RSPP	15	155	70	240	11.2
Commodity exchange transaction under the RSPP	0	13	3	16	0.7
Short-listing system and preliminary announcement – invitation	0	25	36	61	2.9
Competitive dialogue	0	0	0	0	0.0

Source: PPA.

### 3.4. ABUSE IN THE CONSULTING AND INTERMEDIARY SERVICES IN THE ENERGY SECTOR

The sector has the practice of awarding public procurement contracts that cannot be justified on any essential technical, economic or other public grounds. Consultancy services deserve special attention from the perspective of efficiency and benefit as they are most difficult to quantify (or evaluate in qualitative terms) and therefore sectoral contracting authorities have special liking for these services. The reason is that the value of human resources is not analyzed in such procedures. The main costs in consultancy are the labor costs and the costs related to the servicing of the personnel (transportation, office costs, communications, information services, accommodation). All material costs are easily comparable in the competitive bids. Fees, however, are allowed to vary a

lot and are typically calculated in the form of person-days or hours. The problem in the energy sector is that a detailed analysis would point to either incredibly expensive labor per unit of time or too long work with too much staff or both. If the requirements to the bidders and the technical specifications were worded accurately, the competition among the bids would be mainly price-based and ultimately consultancy services would drastically reduce their value, as is in fact the case on the free market. But in the energy sector the market for consultancy services cannot be considered free because of the lack of serious competition, the reasons for which are subjective rather than objective.

The practice of organizing and holding public procurement procedures with the sole purpose of ensuring income for the contractor is quite common. The compliance with the European environmental protection and safety standards provide favorable conditions for corrupt practices, including those in the supply of goods and construction works. Thus the corruption potential in the energy sector is the highest among all spheres of the public sector. The problem is that there is no authority to decide which contract for the supply of goods or services was necessary and which was not. With regard to big contracts this function could be performed by SEWRC in the course of the review of the annual business plans of energy enterprises. The latter should have the obligation to submit their public procurement plans for each calendar year with the related justifications and cost plans.

#### **Box 6. The EIA procedure for Belene NPP**

In connection with the Belene NPP, NEC signed two initial contracts: one for the preparation of an environmental impact assessment and the other one for a feasibility study for the purposes of drafting the report to the Standing Committee for Energy at the National Assembly. The contracts were signed with Parsons E&C Europe Ltd. The price was set at about \$7.7 million. The media reported that the price of previous studies with similar content was approximately \$150 thousand. When labor input costs were re-calculated according to the generally accepted rates (in the United States and Europe) for external experts, the price of the contracts was estimated to be not more than \$1 million. A possible explanation of that drastic difference is that the contractors were selected without any procedure under the LPP. The ironic remark of one of the experts was that “there is no law to prevent NEC from spending 50 times more of the money of Bulgarian consumers of electricity”.<sup>25</sup>

The representatives of the energy sector justify the involvement of consultants in the development and implementation of large-scale projects with the existence of such a requirement in most loan agreements. On the other hand, they refer to the requirement under the *Law on Spatial Planning and Development* to have such consultants. In other words, officials in the energy sector argue publicly that they had no choice but to make big projects more expensive and, in spite of all their claims for high professional level, they could not possibly develop their projects without external consultants.

<sup>25</sup> Mathew Brunwasser, *The Long Way to Belene or Why Only Petty Violations are Punished*, available online at <http://mediapool.bg/site/project/files/belene.shtml>.

The consultancy market in the energy sector is dominated by several linked companies (*Appendix 3*). The situation with the exporters of electricity is similar with some major companies being the key players in both sectors. The monopolization of both markets is inconceivable without the active support of the leadership in the sector and the main energy enterprises which, in turn, generates corrupt practices. The problem in this case is that the distortion and circumvention of public procurement procedures lead to less competition.

**Box 7. Procedure for the selection of a consultant for Maritsa-East 2 TPP**

Maritsa-East 2 TPP announced a public procurement procedure to select a consultant under the *Law on Spatial Planning and Development* for its ongoing investment project – rehabilitation of unit 1 to 6 and construction of desulphurization installations at units 1 to 4. Three candidates submitted their bids. The most beneficial bid at a price of about €9 million was filed by the US company C&L Engineers Limited in consortium with Energoprojekt AD, Sofia, which had no ongoing projects in the sector. After the bids were opened, the contracting authority discontinued the procedure pointing out the reason that it had no resources. The termination of the procedure was appealed by Parsons E&S Ltd. which had been eliminated. The decision of the contracting authority was reversed by the Regional Court of Stara Zagora and the reversal of the decision was subsequently confirmed also by the Supreme Administrative Court. Several months later – already in the following calendar year - a new procedure was announced and the wording of the service sought was modified only slightly remaining identical to the previous one in its essence. There was only one bid from Parsons E&C Ltd. which failed to win in the earlier procedure. The company held a sizeable portion of the market for such services and the price of its bid was about €18 million or twice higher than the bid of the other participant eliminated in the earlier procedure. This time the authorities had no difficulty in providing the financial resources although they were much greater in size than before. The only bidder Parsons E&C Ltd. was announced to be the winner and a contract was signed at the price quoted in its bid.

Source: Administrative Case No. 298/2004, Decision No.298/21 January 2004 of the Regional Court of Stara Zagora and the materials in administrative case No. 4245/2005 and Decision No. 9115/19 October 2005 of the Supreme Administrative Court, 4th Division

The usual position of government institutions with regard to the monopolization of the market for consultancy and intermediary services is that there are no companies holding dominant position. They substantiate it by referring to market shares as percentages of the total turnover or the total number of contracts per contractor. What is omitted in these arguments is that some companies, which are public procurement contractors, are linked to each other and so are their subcontractors. More often than not, relationship schemes generate conflicts of interest, although manifested in different public procurement contracts. The reason is that the same company may act as the contractor under different public procurement contracts but within the same investment project or with the same contracting authority. Sometimes the government administration acting as the principal and the sectoral contracting authorities cite opposite arguments. They claim that the range of experts and consulting companies is very narrow and this naturally limits their choice. This, however, raises the question why some consulting companies win public procurement tenders abroad but they cannot win in Bulgaria. And conversely, why the most successful bidders in Bulgaria do not have the same success in other countries?

### 3.5. ANTI-CORRUPTION MEASURES IN PUBLIC PROCUREMENT IN THE ENERGY SECTOR

An important prerequisite for the limitation of corrupt practices in the energy sector is the existence of a comprehensive national energy strategy and the optimization of the energy balance on this basis; the compilation of a list of the strategic facilities of national importance in the energy sector and the need for new production capacities. All this calls for a genuine public debate because it will involve the spending of billions of taxpayers and consumers levies (including the sovereign guarantees) in the next 10 to 15 years.

Government officials should be subjected to continuous public pressure to fully exercise their rights of the principal in the companies generating electricity and heating. This includes comprehensive monitoring and control, including court remedies sought by the government as the shareholder against the management of its own companies. Such an option is envisaged in the Commercial Code but there is no evidence that it has ever been invoked. For this to happen, new obligations - together with non-compliance penalties - should be introduced for the principals. This could be done in the *Regulation on the Exercising of the Rights of the Government in the Companies with State Interest*.<sup>26</sup> At present, the Regulation (Art. 11, subpara 12) envisages only the right but not the obligation of the company to seek damages from the manager or the comptroller as a prerogative of the sole owner of the capital. SEWRC should be empowered to exercise real control over the business plans of electricity producers. The Commission still fails to demonstrate a capacity for economic analysis which makes unjustified or poorly justified price increases possible. It is efficiency, i.e. the ultimate effect in the money/capacity/environmental effect ratio that can and must underlie price increase assumptions.

A serious debate should be initiated among the experts as to the efficiency of the existing production capacities. It is necessary to analyze the cost per unit of installed capacities and then calculate and add the costs for servicing financial arrangements and for building the requisite infrastructure.<sup>27</sup> Only then the cost can be compared to similar projects abroad so that the gauge the efficiency and public benefit of the respective project.

The introduction of a public monitoring system of procurement in the energy sector is urgent. For this purpose, a model should be developed and proposed to the government. This could be done by the non-governmental sector, including the Consumer Protection Organization. On the one hand, the system would enhance

<sup>26</sup> Adopted with CoM Ordinance No. 112 of 23 May 2003, promulgated in The State Gazette, No. 51 of 3 June 2003, actual entry into force on 16 February 2007. The Regulation mentions corporate responsibility in two cases: responsibility of the manager or liquidator in their management contracts and the release from responsibility as grounds for release of the management performance bond.

<sup>27</sup> A well known fact is that the cost of the electricity lines (about \$1 million per km on the average) to be established for the Belene NPP is not included in the estimates. Even without these financial and infrastructure costs, the price per kW of installed capacity in Belene is currently estimated to be about €2,000, whereas in Russia and the countries using similar technologies it is reported to be €1,500.

the confidence of consumers in the energy policy; on the other, it would minimize the damage caused to the sector by excessively expensive or unnecessary public procurement contracts. It is also necessary to work out a system of indicators for the corruption risk in the public procurement sphere in general, and the energy sector in particular, which could provide the underpinnings of continuous public monitoring of the spending of resources in the energy sector. The analysis of the current practices in the public procurement and the energy sector leads to the conclusion that the following indicators could be initially contemplated:

- unjustified increase of the corporate expenditures of energy producers and electric distribution companies over a certain period. An additional indicator in the nuclear energy sector could be the existence of much higher operational costs in comparison to similar power plants in countries with market-based energy sector;
- undue reduction of the profit of these companies over a certain period, accompanied by inexplicable increase of the profitability of ancillary activities based on outsourcing or the profitability of contractual partners;
- immediate reshuffling of the management after parliamentary elections without transparent and clear reasons (as an indicator of getting hold of resource-intensive business entities);
- repeated public procurement procedures seeking the same service;
- unjustified termination of public procurement procedures;
- involvement of the same consultants in different roles and at different extent of domination of the market for consultancy services;
- systematic avoidance of commodity exchange transactions in the typical purchase of commodity goods;
- linkages between companies one of which is the consultant in an investment project, another is the buyer or the consultant in a privatization procedure, and still another is a contractual partner to a producer or wholesale or retail distributor of energy.



#### 4. REDUCTION OF THE CORRUPTION RISK IN PUBLIC PROCUREMENT – BALANCING ECONOMIC AND ENFORCEMENT POLICIES

As Bulgaria was preparing to meet the EU accession criteria and introduced several comprehensive changes to public procurement arrangements, the regime was generally made to comply with the EU Directives. Hence the prevailing opinion that the legal optimization process has been more or less completed as regards of the reduction of the corruption risk. The claim that the national legislation is basically harmonized with the *acquis communautaire* is to be accepted with some reservations. There still remain essential differences with regard to the legal regulation of concessions and also to the termination and cancellation of public procurement procedures. The harmonization with the *acquis* in the public procurement sector is not a one-off act; it is a dynamic process of reflecting the continuously changing market challenges in domestic legislation. For example, the common European regulatory standards for appeals in the public procurement sphere are still being adjusted. Being a full EU member, Bulgaria should already have its active position in the drafting of European policies.

Besides, the high levels of corruption risk and corrupt practices in this sphere come to show that the harmonization is not a goal for its sake but also a tool to reduce corruption. The harmonization of the legislation of the EU Member States is primarily intended to safeguard the equal treatment of suppliers and the free movement of goods, services, people and capital within the single market. Since these freedoms are related to transparency and free and fair competition, the harmonization produces an anti-corruption effect, too. But it cannot resolve the specific problems and challenges facing the governance of the public sector in the individual member states. Ultimately, each member state is responsible for the level of corruption in it.

There are several groups of tools to reduce and prevent corruption in the process of awarding and implementing public procurement contracts in Bulgaria. They point to the possible priorities for the policy pursued in this area:

- a) optimization of the legal framework towards more transparency and competition in public procurement; increase of the percentage of commodity exchange transactions and e-tenders;
- b) enhancement of the effectiveness of legal remedy and control mechanisms;
- c) strengthening the administrative capacity and more stringent requirements to the professional ethics of the responsible officials in the contracting authorities;



- d) increasing the effectiveness of criminal prosecution;
- e) introducing effective control over the property and income affidavits submitted by senior officials;
- f) optimization of the legal framework regulating the financing of political parties and election campaigns, including independent candidates;
- g) development of legal framework regulating conflicts of interest in parliament, including regulation of lobbying.

In the case of most of these tools, it is necessary to foster their effectiveness and to bring them closer to good European practices. The opportunities for that are discussed below.

#### 4.1. PROMOTING COMPETITION AND TRANSPARENCY

The general objective of the legal framework of public procurement is to ensure maximum competition at minimum compliance costs for the *bona fide* participants. This objective also points to what the main dimensions of the effectiveness of public procurement arrangements should be. In accordance with the *acquis communautaire*, the *Law on Public Procurement* in Bulgaria identifies three major principles underlying the legal framework of public procurement: openness and transparency; free and fair competition; equal treatment and non-discrimination. They shape the framework for the assessment of the effectiveness of the public procurement regime. The point is whether these arrangements provide maximum transparency, competition and equal treatment of suppliers and contractors. These criteria serve as a point of departure in the evaluation of the corruption risk level, as well as in the identification of the most vulnerable aspects of the legal framework in the public procurement sphere.

Over a rather short period of time, the legal framework of public procurement in Bulgaria went through substantial evolution towards its harmonization with the changing European legislation. The main thrust of the reform process was to reduce the barriers at the input of public procurement procedures, while optimizing the ex-post control and enhancing the guarantees for competition. At the same time, however, certain changes were carried out by providing more opportunities for discretionary and non-competitive selection of suppliers by the responsible officials.

The initial *Law on the Awarding of State and Municipal Public Procurement* of 1996 was short-lived but it can be assessed positively as the first step in the introduction of the legal figure of public procurement and its acceptance as an indispensable element of the modern organizational culture in the public administration and public service operators. The ongoing process of harmonization of the Bulgarian legislation with the *acquis communautaire* and the inefficiency of many legal provisions called for the adoption of a new *Law on Public Procurement* (LPP) in 1999.

The European legislation, in turn, has also been evolving. There were four directives in the public procurement sphere until 2004,<sup>28</sup> and they were entirely replaced by two new directives in 2004.<sup>29</sup> The deadline for the EU Member States to adjust their national legislation to those directives was 31 January 2006 (the deadline for Bulgaria was 1 January 2007). Therefore Bulgaria had to repeatedly adjust its legislation to the developing *acquis communautaire*.

The groundwork of today's legal framework of public procurement in Bulgaria was laid with the new *Law on Public Procurement* of 2004 (promulgated in The State Gazette, No. 28 of 6 April 2004; entered into force on 1 October 2004). The public procurement regime was considerably liberalized in accordance with the European legislation. For instance, the scope of application of the LPP was narrowed and the value thresholds were almost trebled to 1.8 million levs for construction works, 150 thousand levs for the supply of goods and 90 thousand levs for the provision of services. The contracts below these thresholds became subject to the easier procedural rules set out in the *Regulation on Small-Scale Public Procurement* (RSPP). Besides, the open procedure could be replaced by negotiations with a specific supplier under certain terms and conditions. The thresholds under the RSPP, below which no procedure was required, were also raised. After the changes in the European legislation of 2006, the LPP underwent so many and essential amendments (promulgated in The State Gazette, No. 37 of 5 May 2006; entered into force on 1 July 2006) that, for all practical purposes, we are faced now with the successive fourth new regulatory framework of public procurement in Bulgaria over the last ten years. Public procurement thresholds were modified and differentiated once again (Table 7).

**Table 7. Thresholds for public procurement procedures (levs, net of VAT)**

Subject-matter	Under the LPP	Under the RSPP	No formal procedures	
			With 3 bids	Without 3 bids
Construction works	Over 1,800,000	100,000 – 1,800,000	45,000 – 100,000	Below 45,000
Goods	Over 150,000	30,000 – 150,000	15,000 – 30,000	Below 15,000
Services	Over 90,000	30,000 – 90,000	15,000 – 30,000	Below 15,000
Design competition	Over 30,000	10,000 – 30,000		Below 10,000

Note: These thresholds do not apply to public procurement contracts to be implemented outside the country either under the LPP or under the RSPP. Source: Center for the Study of Democracy.

<sup>28</sup> Directive 92/50/EEC relating to the coordination of procedures for the award of public service contracts, Directive 92/50/EEC coordinating procedures for the award of public supply contracts, Directive 93/37/EEC concerning the coordination of procedures for the award of public works contracts and Directive 93/38/EEC coordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sector.

<sup>29</sup> Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (often referred to as "the Public Sector Directive") and Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procedures of entities operating in the water, energy, transport and postal services sector (often referred to as "the Public Services Directive").

These thresholds have never been an effective barrier to corruption because of the wide-spread practice of fragmentation of public procurement contracts into smaller portions in order to evade a competitive procedure (typically an open procedure, open competitive bidding or a public tender). The LPP defined such practice as circumvention of the law which distorted the selection procedure and the contract itself.

In addition to the thresholds, the legislation substantially changed with regard to the **LPP scope of contracting authorities**. The group of contracting authorities included not only the sectoral contracting authorities from the public utilities but also companies and non-profit organizations in which the government has a prevailing or dominant influence in the decision-making process. The law-makers' assumption was that in such cases managers in the public sector had the opportunity to transfer public funds to the private sector. Those were, for instance, the cases where the government, or perhaps a municipality, held shares in a company in a sufficient quantity to direct the decisions of the general meeting of the partners/shareholders on the distribution of dividends. The voluntary refusal of the principal to receive that source of income wholly or in part represents actually indirect disposal of budget resources. They were infused back into the company and therefore it had to fall within the scope of the LPP. That group included sole-owner companies, as well as all joint ventures with government or municipal interest, where the government or municipality had retained a blocking quota in the decision-making process. The legislative solution complied with the definition and interpretation of the concept "contracting authority" within the meaning of Art. 1, para 9 of *Directive 2004/18/EEC* of the European Parliament and of the Council of 31 March 2004.<sup>30</sup> The definition covers also persons controlled or supervised by an organization (entity) governed by public law or having a collective governance body, more than half of whose members are appointed by an organization governed by public law.

Finally, for the last few years the set of tools at the disposal of public procurement contracting authorities has been considerably enriched with regard to the types of procedures. On the one hand, it has developed towards greater transparency with the introduction of e-tenders and commodity exchange trading. But on the other, the broadening of the range of tools tends to move towards more negotiations. The existing legal framework envisages such tools for the awarding of public procurement contracts and the acquisition of goods and services as the competitive dialogue, negotiations with or without announcement, dynamic supply systems and framework agreements. All of them imply a certain degree of restriction of the access of participants and greater discretionary powers of the contracting authority in the selection of the supplier/contractor which increases the risk of corruption. Does it mean that they have no place in the legal framework of public procurement?

As stated earlier, the economic efficiency of public procurement depends mostly on maximum transparency, equal treatment and competition among suppliers. But it depends also on the unlimited consumer choice of the contracting authority,

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<sup>30</sup> The Public Sector Directive

alongside with these legislative principles. From the perspective of the public interest and fair competition, it is important not only for the contractors to have equal access to the public procurement market but also for the contracting authorities to have access to the market on equal footing with the other consumers from the private sector. The transaction costs incurred by both the public and the private sector should not be higher than the public benefits from the distribution of public procurement contracts on a competitive basis. These two relatively underestimated principles of economic efficiency guarantee that the public sector will not consume goods and services at prices which are higher than the market ones. The problem is that they do not always imply decisions that ensure maximum guarantees against corruption. This issue becomes increasingly relevant with the development of the knowledge-based economy, the need for choice among high-tech solutions associated with asymmetry of information between suppliers and consumers. It calls for new commercial practices where, together with transparency and competition (which play the leading role in non-differentiated products), increasing importance is attached to partnership relations, trust and confidence, information and expertise, as well as the freedom of choice of the contracting authority in selecting its suppliers. In other words, with respect to many high-tech goods and services the use of negotiations - provided that there is no abuse of such procedures - serves the public interest much better than the conventional open procedure. In this context, the challenge for the anti-corruption policy is to strike the proper balance between the limitations of the procedures and their economic efficiency. In a nutshell, the solution is not to restrict negotiation procedures but to limit the opportunities for their discretionary application or for their use to personal benefit. Of course, this makes the tasks of control in this sphere ever more difficult as it requires increased relevance of **expediency judgments** alongside with **legality considerations**.<sup>31</sup>

Generally, Bulgaria has modern public procurement legislation which complies with the requirements of the EU Directives in its spirit and content. Naturally, its effective enforcement largely depends on the administrative and judicial capacity. A new phase of harmonization of the LPP is expected in the near future because of the upcoming changes in the European legislation concerning the administrative and judicial control in the process of awarding public procurement contracts.

## 4.2. E-TENDERS

E-tenders are a relatively new tool in the public procurement sphere. They are regulated in the two EU Directives of 2004 and they were incorporated into the Bulgarian national legislation with the latest amendments to the law in 2006.<sup>32</sup> However, their practical application is still very limited. The Ministry of Finance keeps the e-tender register for small-scale public procurement covering mainly the public tenders within the framework of the pre-accession funds. Modest as it is, the experience gained so far comes to prove that they are very appropriate

<sup>31</sup> Directive 89/665/EEC on review procedures and Directive 92/12/EEC on sectoral contracting authorities

<sup>32</sup> See Pavlova, M., *New Public Procurement Procedures Envisaged in the EU Legislation* (in the Bulgarian language), Pazar i Pravo Journal, No. 5, 2006.

for attaining maximum competition and access to the market at minimum costs for the participants in the procedure. The scope of application is confined to goods with clear qualitative parameters, where the major criteria and the price and delivery time-table. Such supplies are possible not only in the case of small-scale public procurement. E-bidding should become the rule in all possible cases, that is, when the quantitative and qualitative parameters of the supply are clearly defined. It is somewhat more difficult to apply this procedure to construction works and other services, although there are some examples to this effect. The share of e-tenders could be a good measure for the determination of the respective institution to restrict corruption in the public procurement sector.

### 4.3. LEGAL REMEDIES

The legal protection and control system, too, has undergone serious evolution. Administrative and judicial control under the general provisions of the *Law on the Administrative Procedure* was quite limited initially and subsequently the applicable provisions became those concerning the general procedure of filing claims. The main reason given was the inefficiency caused by the time limits for hearing court cases and the prospects for suspension of public procurement proceedings against the backdrop of the urgency and volume of the economic, legal and public interests interwoven in a public procurement procedure. Over the period from 2004 to 2006 it reached the paradoxical state of administrative acts issued in the public procurement process being challenged under a special procedure at the district courts. A lot of resources were spent at that time to train magistrates of first-instance courts who were not familiar with that matter. In 2006, the legal protection system was reshuffled once again and the first-instance control was entrusted to the Commission for the Protection of Competition (CPC). It is too early to say whether that measure is effective or not. One of the main problems it will encounter is the lack of human and material resources to cope with backlogs. A certain barrier to the malicious appeal is the financial guarantee to be paid by the contestant as a provisional security measure in the amount of 1% of the value of the transaction.

It is necessary to review some procedural rules concerning the liability of the central and local governments for damage inflicted on individual citizens. Regressive action against the official who has made the public institution liable will have to become mandatory in certain or most cases, depending on the nature of the liability.

A major problem in the redress arrangements is the use of the term “legal interest” when administrative acts are challenged before a court of law. Many acts of the highest body of the executive power cannot be contested by anybody because for this to take place the contestant has to prove that he has personal and immediate interest in the repeal. For example, the decisions concerning the largest investment projects that are supported or launched by the government cannot be challenged because they do not affect anybody **personally** according to the applicable interpretation of the term. The paradox lies in the fact that it is exactly decisions that affect **everybody** cannot be challenged by **anybody**. Thus



the prevailing interpretation of the term legal interest is a statutory brake on the challenging of decisions of special public importance.

Legal interest is an essential element of the active legitimization in the civil and administrative process. It boils down to the questions “Who can challenge the acts of the contracting authority?” and “Who can request the court to announce a public procurement contract, awarded without due procedure, null and void?” The concept of “any party concerned” (Art. 120, para 2 LPP) gives the formal answer to the former question. The court practices under the two consecutively repealed laws on administrative procedures (LAP) of 1971 and 1979 have left the concept that the interest of a person is legitimate if it is: (i) legal; (ii) personal; and (iii) direct (immediate). This has been the court practice since 1976;<sup>33</sup> there is also a judgment to this effect ruled by the Constitutional Court.<sup>34</sup> At present, Art. 147 of the *Code of Administrative Procedure* (CAP) recognizes the interest in attacking an individual administrative act to a person whose rights, liberties or legitimate interests are infringed or threatened by the act or a person for whom obligations arise out of the act. However, the formal definition is limited by the third element of the wording cited above, i.e. whether the interest is immediate or not. In the context of the LPP, potential direct infringement of interests would exist only with regard to the entities which are (pursuant to Art. 6) the contracting authority, the bidders, the participants and the contractor. The relevant definitions in the LPP (see § 1 of the *Additional Provisions*) leave no opportunity for broader interpretation. Similar is the treatment of this issue in the two existing EC Directives on the legal protection in public procurement.<sup>35</sup> *Directive 89/665/EEC* recognizes the legitimate interest of persons who have or had interest in winning and being awarded a public procurement contract; this principle is further developed by the European Court of Justice also with regard to the persons who are affected or could be affected by infringements in the awarding of public procurement contracts.<sup>36</sup> This generally exhausts all opportunities for civil society to intervene in the way in which public funds are spent.

The practice in Bulgaria knows no exceptions, apart from the area of environmental protection. Pursuant to Art. 9 of the Aarhus Convention<sup>37</sup> environmental non-governmental organizations have the explicitly recognized right to challenge acts of public authorities which could affect the environment. However, there is no such international or national procedural rule with regard to public procurement

<sup>33</sup> At that time, *Ruling No. 4/76* of the Plenum of the Supreme Court was adopted with the objective to summarize and bring uniformity in the practices under the *Law on Administrative Procedures* of 1971. It largely became the point of departure for the doctrine of the administrative process for decades on end, including the subsequent interpretative judgments related also to the understanding of legal interest in challenging administrative acts.

<sup>34</sup> See Judgment No. 21 of 1995 of the Constitutional Court on the objective element in the infringement of personal interests.

<sup>35</sup> *Directive 89/665/EEC* on review procedures and *Directive 92/12/EEC* on sectoral contracting authorities

<sup>36</sup> Hackermuller ECJ 19/6/2003 C-249/01; also Fritsch, Chiari & Partners C-410/01.

<sup>37</sup> *Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (Aarhus Convention)*, ratified by a law adopted by the 39th National Assembly on 2 October 2003; promulgated in The State Gazette, No. 91 of 14 October 2003. The text of the Convention was published by the Ministry of the Environment and Waters, The State Gazette, No. 33 of 23 April 2004 and entered into force on 16 March 2004.

A kind of breakthrough can be seen only in the practice of the European Court of Justice which assumes that third parties can be legitimized to challenge public procurement procedures, where discriminatory terms of reference have disallowed them from participation.<sup>38</sup> EU Member States are not strictly bound by this ruling. Conversely, they can envisage easier access to justice of a broader range of persons. Whether and how this can be done is a matter of national legislation.

The issue at stake in Bulgaria is how the review of the legal interest concept can expand the opportunities for effective public control over the awarding of public procurement contracts. A tangible step forward are the general provisions on legal interest in attacking administrative acts under the new *Code of Administrative Procedure* (more specifically, Art. 147, para 1 and Art. 186, para 1). It is for the first time that the Bulgarian law-makers explicitly recognize the right of citizens and organizations whose rights, liberties or legitimate interests are affected or could be affected to challenge individual and statutory administrative acts. This approach sets the beginning of the long awaited constitutionalization of the administrative process perceived as a shift primarily to the protection of the constitutional rights and freedoms of individual citizens and their organizations.<sup>39</sup>

The next possible step is the introduction of class action which could render meaningful the provisions of Art. 120a of the LPP. Otherwise, they would seem only palliative because the prevailing understanding of legal interest in challenging acts before the court of law is still strongly restrictive. Class action would lead to significant procedural economy because court judgments would become enforceable with regard to all affected consumers who suffered from the same action or inaction of the defendant, although only one or a few brought the case to the court. But this would call for substantial amendments to the *Code of Civil Procedure (CCP)*. The time for the introduction of class action is quite appropriate because of the upcoming debate on the draft of a new CCP.

#### 4.4. CONTROL

The institutional ex-post control is entrusted to three agencies. The Public Procurement Agency at the Ministry of the Economy and Energy is responsible for the overall coordination and conduct of tender procedures and maintains the Public Procurement Register (PPR). The National Audit Office performs the external audit functions, i.e. it exercises supervision mandated by the legislative power with regard to the lawfulness of public procurement procedures. However, it has no powers to impose sanctions when irregularities are detected; it can only advise the Parliament and the Ministry of Finance. The internal audit is carried out by the Public Financial Inspection Agency (PFIA which was the Public Internal Financial Control Agency or PIFCA until 2006). It has more powers to check not only the compliance with the legislation but also the quality and outcome of

<sup>38</sup> Grossmann Air Services, ECJ 12/2/2004, C-230/02.

<sup>39</sup> The lack of constitutional justice at the appeal of the party concerned casts a shadow on both the direct effect of the Constitution and the opportunity for protection of the constitutional rights and freedoms of citizens. In the latter case, the only remedy is the administrative process in the court of law.



public procurement procedures. The process of absorption of budget resources and EU funds will be monitored and audited also by internal auditors at the contracting authorities in pursuance of the *Law on the Internal Audit in the Public Sector and the Law on the Financial Management and Control in the Public Sector* which were adopted in the beginning of 2006. The effectiveness of this control is based on adding expediency considerations to its scope. Increasing importance is attached to the ex-ante review and risk management, the establishment and monitoring of the compliance with rules of ethics, the development of written policies and the introduction of a monitoring system. Still, the effectiveness of internal audit should be also subject to monitoring and public accountability. In this sense, it is necessary to use a modern risk assessment system and to broaden the scope of audits in big transactions, i.e. in value terms the internal audit should cover some 60% of the contracts awarded at the implementation stage. Currently, it does cover 60% of the contracts but they account for only one-third in value terms.

Whatever the forms of legal and administrative protection and control, they cannot sufficiently compensate for the public and individual losses incurred in a poorly conducted procedure. The forms of retroactive control could be effective only if they create conditions for serious prevention of future infringements. In this sense, the CPC is faced with great challenges but it hardly has more capacity to meet them than district courts have on a short-term basis. Urgent measures are needed to strengthen the CPC capacity to handle appeals. Special attention should be paid to the so called secondary guarantees of legality, such as the collateral to be paid by the appellant, the suspension of the procedure only at a decision of the CPC, the internal audit work in the public administration and the monitoring systems and the compliance with the rules of ethics by public procurement officers.

#### 4.5. IMPLEMENTATION OF THE CONTRACTS

At present, the legal framework with regard to public procurement covers only the awarding procedures, i.e. the whole process up to the signing of the contracts. The only subsequent guarantee against abuses is the ban on changing the contracts once they have been signed. The purpose of this provision is to curb the practices which were quite common until recently, i.e. to sign annexes to the contracts so that to change the parameters which were indicated to win the contract.

However, the LPP contains no guarantees and control mechanisms against abuse in the implementation phase. The risk of deviation from the contract with the tacit consent of the contracting authority is significant in the case of construction works which account for a half of the value of all contracts and also in services. Such corrupt practices remain beyond the remit of financial control or sanctions. A partial barrier to compromises with quality in the implementation phase could be a more detailed regulation on the performance collateral required in construction works and services. It would be even better to optimize the investor's control functions in the implementation of public procurement contracts, especially in

construction works. This, too, might prove quite difficult since the investor's control is not immune against corruption either.

#### 4.6. MONITORING

Transparency and the monitoring of the public procurement process are among the most important elements of the protection against corruption in this sphere. The main tool to this effect is the Public Procurement Register. Its establishment was undoubtedly a step forward in enhancing the transparency of tender procedures and reducing the corruption pressure. Nevertheless, its use still falls short of optimal levels because not all procedures are registered there yet. Besides, it remains a good source of information about a specific procedure (provided that the contracting authority has registered it) but it is not suitable for monitoring of the process and identification of risk areas and sectors by means of aggregated data. The register should provide not only information about individual tenders but also statistical indicators to assess the level of corruption and corruption risks by awarding sectors and industries (suppliers). An example of such an indicator is the type of procedure. Until 2004 it was possible to use it in order to gauge the percentage of non-tender procedures (direct negotiations, direct awarding, etc.) of the total number of contracts. It would be even better to have the statistics based on the value rather than the number of contracts. But no such breakdowns have been made since the register was transferred to the PPA. The register should make it possible to identify sectors and contracting authorities with high vulnerability on the basis of several indicators of the corruption risk.

In this context, the confidentiality of the information related to public procurement procedures becomes particularly relevant. Public procurement contracts with their numerous appendices cannot be kept secret from the public on behalf and in the interest of which they have been awarded. Pursuant to Art. 31, para 1 and Art. 33, para 4 of the LPP both the contracting authority and the participant have the right to specify which portion of their documentation is of confidential nature and is not subject to disclosure. In practice, however, there is a tendency to restrict the access to the information and documentation related to public procurement as much as possible. This should not be allowed with regard to information that is not protected by law (the latter include personal data, classified information and know-how).

#### 4.7. EFFECTIVE SANCTIONS AGAINST ABUSE

Criminal prosecution of corruption has limited applicability in public procurement. The reasons lie in the very essence of criminal law which focuses on behavior that is entirely or primarily dependent on the capability of conscious judgment and the right of choice of the individual. They, in turn, affect the evidence required in criminal proceedings and therefore the most frequent result from the prosecution of infringements in the public procurement sector is close to zero. Furthermore, the Bulgarian *Criminal Code* does not contain any special provisions to criminalize unlawful behavior in public procurement. It is prosecuted under the general terms and conditions of what is defined as breach of trust under the

well-known Art. 282 CC. No such special provisions would have been necessary if Art. 282 had been effective. But this is not the case and it is sufficient to recall the origin and spread of such an approach in the legislation of other countries.

Law enforcement and economic policies operate on the basis of sets of rules and concepts which have little in common. This is particularly dangerous when some general financial and business concepts are used because their meaning has undergone substantial changes. In spite of its numerous amendments since 1989, the *Criminal Code* is based on obsolete terminology which would be more appropriate for the centrally planned economy. The market economy is associated with many more risks and calls for much greater flexibility. The expectations for profit are not backed by any guarantees. On the other hand, it is very difficult and almost impossible to decide when the loss is deliberately caused and when other reasons prevail. The *Criminal Code* is premised on the theory of universal causality. The issue concerning the relationship between the doctrinal understanding of guilt in the *Criminal Code* and the concepts of modern psychology is similar.

In this context, it is interesting to trace out the links of the public procurement market to gray economy. Such a linkage seems highly improbable at first glance. Public procurement implies the spending of public funds which are typically budget resources. Transactions are associated with greater transparency and accountability, reducing the opportunities for tax evasion and accounting fraud. On the other hand, however, it is precisely for these reasons that the revenues of public procurement contractors enjoy a positive public image to the utmost degree. It is hard to imagine a more legitimate source of revenue than from the state budget. Therefore public procurement is quite attractive for money-laundering purposes. This becomes most apparent when the winner has submitted an inexplicably low-priced bid that is obviously below cost. Such cases are not rare, especially in construction works and engineering. It is no secret that the shadow business tries to find legitimization through “regular” business that is, in a sense, the tip of the iceberg. The new wording of Art. 70 LPP can be assessed positively from this perspective. It envisages the obligation of the public procurement body to require detailed written justification of the price bid which is more than 30% lower than the average price of the other bids. If the committee is not convinced that the arguments stated in the justification are warranted, it may propose to the contracting authority to remove the respective participant from the procedure.

Such a risk, although in the reverse direction, exists in high-value consulting services because, as a rule, it is very difficult to justify or assess costs there. A bid may be unjustifiably high but it might well be the winner if there are no other competitive bids. This would happen when possible competitors are discouraged to take part in the procedure or when the terms of reference and the technical specifications are worded exclusively to the benefit of a certain bidder/participant.

Making criminal prosecution even stricter would hardly produce a tangible effect. More stringent penalties could not be productive at low detection rates and with a small number of persons convicted. The crime detection rates and the number of pre-trial proceedings ending up with indictments in court determine the level of public perceptions as to the inevitability of punishment. Even more important

to this effect is the number of court cases ending up with convictions. These perceptions have a greater deterrence effect than penalties. This is evidenced by the data published in the 2004 and 2005 *Corruption Assessment Reports* of the Center for the Study of Democracy. Over the period from 1999 to 2005, the number of court cases ended with convictions under Arts. 282-283a CC ranged from 30 to 45 and that of the persons convicted was 30 to 50 per annum, although the legal provisions had been amended to make the liability more serious. A similar conclusion can be drawn from the number of pre-trial proceedings and the number of those proceedings which ended with an opinion on the need for a trial over the same period. In fact, since 1993 the number of cases brought to court, the number of indictments and the number of persons convicted have fluctuated only insignificantly for reasons other than the amendments to the substantive law or to the *Code of Criminal Procedure*.<sup>40</sup> Therefore the penal policy can become more effective in Bulgaria only if it is integrated into the other policies pursued by government institutions. Effectiveness can be enhanced through the implementation of simultaneous measures along several lines.

Insofar as the adoption of an entirely new *Criminal Code* is a matter of generally recognized need, it could provide the opportunity to introduce effective provisions criminalizing specific actions in public procurement on the basis of the typical cases of infringements. The reverse argument challenges the justification of the specialization because the general and the special provisions could not be distinguished from one another. An argument to this effect is the criminal liability for breach of trust in the privatization and the disposal of state-owned or municipal property (Art. 283a) introduced in 1997. The trade-off between the two theses lies in the understanding that, generally, it is time to go beyond the prevailing hypotheses of resultant breach of trust in the economy as they prove to be futile. It would be more prospective to criminalize the conspiracy against the market as is the case in many developed market economies. The practice of enforcing the existing provisions of Art. 220 and Arts. 282-285 CC<sup>41</sup> is most unsatisfactory. It has turned out that in a market economy these offences cannot be proved for all practical purposes and they cannot be sued in court. Bribery is even more difficult to prosecute, especially when graft is indirect (through one or more intermediaries) or within the framework of an existing organized group which holds the requisite infrastructure (network of companies in Bulgaria and abroad, bank accounts, money-laundering schemes and other forms of disguise). Thus the possible criminal abuse in public procurement remains unpunished and, in turn, reduces the power of prevention. The only possible outcome is to criminalize conspiracy in the economy and to prosecute money laundering more persistently.

Administrative liability is also within the scope of sanctions. Naturally, many infringements in public procurement procedures do not warrant criminal prosecution under the *Criminal Code* either because of insufficient evidence of

<sup>40</sup> *Anti-Corruption Reforms in Bulgaria*, Center for the Study of Democracy, Sofia, 2005, pp. 39-40; *On the Eve of EU Accession: Anti-corruption Reforms in Bulgaria*, Center for the Study of Democracy, Sofia, 2006, p. 66.

<sup>41</sup> Non-beneficial transaction and breach of trust respectively.

an offence or because of inability to gather admissible evidence or because the infringement does not fall within the purview of the Criminal Code. Nevertheless, the administrative criminal liability should not be underestimated. The new provisions of the LPP (Arts. 127-133) envisage many new cases of liability aimed directly at the contracting authority and its staff. When the public procurement contract is of high value and conditions exist to presume a corrupt transaction, the administrative liability of the procurement officer as a natural person is a relatively weak barrier. The amount of the fine envisaged for such cases is of little relevance. At the same time, the provisions concerning the actions or inactions of other officials involved in public procurement procedures would be much more effective, including from the perspective of prevention. From the viewpoint of the individual motivation of officers, it is very unlikely for them to be prepared to take risks related to the behavior of their superior. An exception to this rule would be the case of their complicity in the respective offence. Therefore one should welcome the introduction of the new provisions of Arts. 127a-129b LPP and, more specifically:

- the actions of officials authorized by the contracting authority to organize and conduct public procurement awarding procedures and to sign the contracts;
- the disclosure of information on the public procurement awarding procedure by a member of the evaluation committee.

Even more important is the fact that the statements on the violations detected are drawn up by officials of the Public Financial Inspection Agency. Their findings could provide legitimate grounds to start pre-trial proceedings; moreover, they could contain sufficient indications that an offence has been committed. The actual prerequisites for this possibility are the professional qualifications of the officials and their obligation under the *Law on the Administrative Violations and Penalties* to collect evidence of the infringement as a precondition for drawing up the statement.

One of the weaknesses of the administrative liability under the LPP is its focus exclusively on the contracting authority, as defined under Art. 7. The problem lies in the definition itself rather than the cases in which this liability can be invoked. Liability is always personal, whereas Art. 7 refers to both organizations as contracting authorities (administrations within the scope of the *Law on the Administration* and legal entities under the *Commercial Code*) and natural persons as heads of administrative structures (bodies) without making any distinction between them. Moreover, the term “organization governed by public law” within the meaning of § 1, subpara 21 of the LPP could exclude (and does exclude in the strictest interpretation of the term) municipalities and their mayors. Since the provisions envisaging sanctions cannot be construed restrictively, the liability of mayors and local governments is put to doubt, especially if the penalty orders are attacked in court under the *Law on the Administrative Violations and Penalties*.



#### 4.8. STRENGTHENING OF THE ADMINISTRATIVE CAPACITY

The adjustment of practices to the legal framework is always a lengthy process. Due to the dynamic nature of legislation from 1999 to 2006, contracting authorities did not always have the opportunity to adapt their operations to the legislative novelties. But the gaining of experience in public procurement enables them to shorten the lead period. The most important accomplishment is the already existing organizational culture of using public procurement as a policy tool in the various sectors and, conversely, making public procurement itself the subject of policy.

Most administrations and other contracting authorities have used the time since the adoption of the LPP for their own institutional development and strengthening of the administrative capacity in the public procurement sphere. The establishment of specialized public procurement management structures has started either as independent units or as bodies performing other administrative functions as well. This has produced positive impact on their public procurement expertise.

The enforcement of the LPP and RSPP in their current wording narrows the loopholes for their circumvention. Parallel to the increased public intolerance to corruption, this reduces the opportunities for practicing the familiar forms of corruption and the introduction of new ones. The reinforcement of this tendency calls for development of public procurement policies along several lines: introduction of rules for ethical conduct in public procurement; development of policies and corporate public procurement plans in each administration which operates as a contracting authority; and strengthening of the administrative capacity to implement international projects with partial or predominant external financing with a view to gaining access to the EU funds.

The introduction of codes of conduct for public procurement officers is not widely discussed. The EU legislation guarantees transparency and equal treatment of the participants in public procurement procedures but everyday practices tend to deviate from these principles by giving preferences to domestic participants or circumvention of the applicable law. It is the rules of ethics that need to offset these negative tendencies and to promote compliance with the European and national legislation in the public procurement sphere. Codes of conduct should fill in the loopholes in the legal framework, guide to proper understanding and interpretation of legal provisions, and foster greater efficiency of public procurement.

The introduction of codes of conduct for civil servants and all other public procurement officers is a recognized need. Compliance would greatly reduce infringements and create preconditions for intolerance to them within administrations and corporations. Such model rules have already been drafted and what remains for government authorities is to adopt them for their respective administrations and make arrangements for their application. The rules could serve as a quality criterion in administrative work. Their use for the purposes of the certification systems in the administration could turn into a powerful incentive not only for their formal adoption but also for their application in day-to-day work.

The systematic human resources training should run for magistrates and controlling bodies at the same time, as well as for the personnel of the public and corporate administration on issues of common interest. An example of such issues could be public procurement, particularly with regard to the standards set out in the EU Directives and the case law of the European Court of Justice in Luxembourg.

Equally important for the strengthening of the administrative capacity is to gradually move the administrations of contracting authorities away from political influences through the recruitments systems and to enhance the independence of their middle management level. This is relevant also to the appointment of public procurement committees and to their rules of procedure as their members should be as independent from the political offices as much as possible. Parallel to it, positions for compliance monitoring officers could be opened so that they could supervise the observance of legal and ethical standards in close interaction with civil society institutions and media. Such positions could be opened at the inspectorate departments of the respective conventional contracting authorities and the regulators in the utilities sector.

#### 4.9. REGULATION OF THE FINANCING OF POLITICAL PARTIES, LOBBYING AND PUBLIC-PRIVATE PARTNERSHIPS

As well as the internal factors and prerequisites within the public procurement system, the reduction of the incentives and preconditions for political corruption, which generates corruption also in public procurement, should be the focus of the anti-corruption policy. Otherwise the optimization of the legal framework of public procurement with all its components would not produce the desired results. The main highlights are the financing of political parties, the regulation of political lobbies and public-private partnerships.

**The financing of political parties** remains high on the agenda. There are strong public expectations of a solution while at the same time there is no tangible progress. By definition, each political party is an organization for systematic exercise of public influence. When coupled with higher level of organization and discipline it becomes potentially dangerous if the party falls prey to corrupt motivation and standards of conduct. In fact, the problem becomes public when the party leadership is fully or partially in the hands of people whose value systems and life priorities deviate from the generally accepted goals and principles of political life. These are cases in which the individual behavior is most easily transformed into the dominant organizational conduct. For these reasons, political favoritism of certain businesses is already a highly reliable indicator of corruption. The transparency of financing is a still unresolved problem. Unlike public benefit NGOs, political parties do not submit financial reports that are sufficiently open to the general public. Indeed, their reports are submitted to the National Audit Office which audits them and publishes them in its bulletin and on its web site (Art. 34, para 5 LPP). However, the truthfulness and completeness of the financial documentation made available are not checked. It is only formally irregular files that go to the National Revenue Agency. It is impossible for the time being to counter-check the sources of financing if the political party has formally fulfilled its obligation to draw up seemingly impeccable financial reports. But this does



not particularly enhance the public confidence in the way in which political life is financed in Bulgaria.

On the other hand, it is necessary to analyze whether the domestic legislation concerning political parties is adequate and realistic. The financial constraints are so formidable that there is hardly any political party capable of unconditional compliance. The ineligible financial sources are enumerated in Art. 24 of the LPP, including anonymous donations, whereas the preceding provisions allow fund-raising activities. These two concepts are defined in § 1, subparas 1 and 3 of the law.<sup>42</sup> The definition makes it clear that any collection of money could be considered a fund-raising activity, including the collection against promises to achieve certain political and economic results. No distinction is made between the cases when an individual requests funds and the specific activities targeted to an indefinite or broadly defined audience at which the party, or its representatives, put forward their platform and solicit financial or material support but in an unconditional manner.

It is widely known that the amount of the state subsidy (for parties represented in parliament) and membership dues is insufficient to ensure normal party operation and running in elections. Election campaign costs have increased drastically in the last ten years and this is a trend not only in Bulgaria but also in all democratic countries. The growing influence of the media and the media presence of political parties inevitably sustain this trend. Political activities become ever more technological and professional, while the voluntary participation and the personal financial input lose grounds. A large portion of the party expenditures will remain hidden from society. The typical examples to this effect are the expenditures a media presence, promotional materials (especially in election campaigns), rents and support of halls and clubs, concerts and other promotional events, transportation and accommodation costs. A national party event, for instance, implies the traveling of several hundred to several thousand people, something that is hardly affordable even to the biggest representatives of the corporate world, not to speak of the massive or group transportation of voters or the organized “vote shopping” among certain groups of the electorate which have been repeatedly covered by the media.

It is also well-known that much of the financing of political parties is provided by ancillary organizations, sometimes in cash and often in kind, insofar as media and other costs could be presented as corporate expenditure (promotion, advertisement, encouragement of sales, business development, etc.). The advancement of privatization and the obscure relations between the corporate environment and politics, which are still in the making, limit the possible sources of financing. This drastically enhances the importance of public procurement as a source and provides the logical explanation of the parameters of political corruption in the awarding of public procurement contracts. It is not sufficient to have the legal ban on the financing of political parties with resources of bidders and participants

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<sup>42</sup> 1. ‘Anonymous donations’ are donations in which the identity or name of the donor are not disclosed to third parties; ... 3. ‘Fund-raising activities’ are collecting activities on the basis of a transaction for consideration or free of charge in the form of money, services or technical equipment to the benefit of a specific political party”.

in public procurement procedures, where the latter have not been completed and the time limit for appeal under the *Law on Public Procurement* has not expired, or resources of a public procurement contractor or a legal entity in the process of privatization. Against this backdrop, the reduction of the corruption pressure on the awarding of public procurement contracts calls for legalization of some existing sources of party financing and elimination of some legislative constraints. This is particularly relevant to the donation arrangements, where the ceilings are too low and certainly inadequate to the needs of a political party. Besides, it is important to take into account the diversity of financing forms, including indirect financing, such as the various forms of contribution in kind by third parties (mainly legal entities) – transportation services, halls, offices, printing, access to electronic media, outdoor advertising, etc. If they are explicitly regulated and treated as eligible donations, the effect would be positive provided that analogous and adequate tax arrangements are introduced. Thus it would become easier to trace out the donations with a view to the other legal constraints, e.g. the ban on the financing by foreign governments and foreign legal entities. Such measures would not be successful without the gradual but consistent minimization of payments in cash which is within the remit of the central bank and the government.

**The regulation of lobbying** is an anti-corruption measure which is quite non-conventional in Europe. It is exactly in the anti-corruption vein that the legislative initiatives of the 40<sup>th</sup> National Assembly to this effect are advertised. Generally speaking, lobbying is not typical of the continental type of parliamentarianism and this is the reason for the lack of such regulation in Europe (except for Poland since quite recently). Although the attempt at introducing such regulation in Bulgaria should be commended in principle, tangible results from its possible introduction could hardly be expected. One of the reasons is that the regulation of lobbying is called to life mainly by the requirements to declare and avoid conflicts of interest. This is a much broader concept than corruption and, in practice, it has little to do with corruption. The bill explicitly bans lobbying under the *Law on Public Procurement* and the *Law on Concessions*. This is to be welcomed because no lobbying should be allowed in strictly formalized procedures in principle. It is still unclear why the privatization process, for instance, is not included in its scope. It is more important, however, that lobbyists can easily circumvent the law by pressurizing through party staff or mimicking as consultants in the public sector. Therefore one encounters the everyday perception that lobbying comes to put order in corrupt practices instead of eliminating them. On the other hand, lobbying does not seem to be a lucrative prospect as long as the levels of political corruption are high. The gray sector of the economy would always opt for direct financing of party coffers and private accounts rather than for payment to expensive lobbyists without any guarantees for the final outcome.

**Public-private partnerships.** The concept of public-private partnerships is defined and used in many different ways. It covers various manifestations of partnership, e.g. joint ventures, joint projects, commissioning of the building and operation of a finished product for a certain period of time (B.O.T. arrangements or similar schemes), concessions, various forms of outsourcing, etc. However, the public opinion is particularly sensitive to the involvement of the central and/or local government in joint organizational forms of business. The public sector almost invariably participates with real estate. The doubts about inefficiency go hand

in hand with the doubts about corruption and they are most frequently caused by the non-transparent choice of a partner and negotiation of the terms and conditions. The existing problems can be out into three main groups:

- lack of rules/grounds for the “when, why, with whom and how” modalities to launch partnerships;
- lack of defined and announced policies for involvement in the various forms of public-private partnership;
- lack of competitive and transparent procedures for the choice of a partner similar to the procedures under the LPP, which constrains competition and hence efficiency.

Generally, public-private partnerships lead to avoidance of the need for application of the Law on Public Procurement once they are established. The exception to this rule is the regime of concessions which are subject to an exhaustive list of rules harmonized with the EU requirements and, basically, identical to those under the LPP. In all other cases, however, PPPs are established on the basis of the general terms and procedures, i.e. pursuant to the *Commercial Code*, neglecting the specific features of public institutions as the principals of business. Their covert goal could be the provision of unilateral competitive advantages which contradicts the logic of public procurement. No cases of public-private partnerships challenges on such grounds have become known so far and they can hardly be expected in the near future. Against the background of these problems, it is urgent to improve the legislation. First and foremost, rules need to be established for these partnerships and especially for the joint ventures between the central (or local) government and other companies with non-predominant state/municipal stake. The rules should be imperative for public institutions and the legal entities they control directly or indirectly, regardless of whether they are business undertakings, associations or foundations. In principle, the range of the entities involved would be identical to that under Art. 7 and § 1 of the *Additional Provisions of the Law on Public Procurement*: “organizations governed by public law”, “public enterprises”, “related undertakings”, etc. The rules should envisage competitive procedures for the selection of a partner, which are identical or similar to those under the LPP and the *Law on Concessions*.

The issue at stake is somewhat different in the case of the implementation of public-private partnerships. The *Law on Public Procurement* contains a number of provisions concerning PPP in order to ensure its application to the newly established partnerships. In the first place, these are the provisions of Art. 14, paragraphs 4 and 5 LPP concerning contracts for construction works or services related to construction contracts which are financed predominantly (over 50 percent) from the budget of public procurement contracting authorities governed by public law. In these cases, construction works are commissioned by a private person but the predominant budget co-financing automatically emancipated this person as the recipient of the financing to the level of a public procurement contracting authority within the scope of the LPP. Secondly, any legal entity which is the partner of a legal entity of a public procurement contracting authority (or which is established through such partnership) can be construed as

an organization governed by public law within the scope of § 1, subpara 21 of the LPP (i.e. a public procurement contracting authority) in any of the following four alternative cases:

- if during the previous year it had been financed mainly from a budget source or an equivalent source;
- if more than a half of the members of its managing or supervisory body are appointed by contracting authorities which are government bodies or organizations governed by public law;
- if the legal entity is subject to managerial control by contracting authorities which are government bodies or organizations governed by public law, i.e. they can exercise dominant influence on the activities of the legal entity;
- if the legal entity is a healthcare establishment – a company of which at least 30 percent of the revenues in the previous year came from the budget or the National Health Insurance Fund.

The application of these provisions depends also on the sector in which the legal entity operates. The conditions enumerated above are applicable only if it has been established to meet public interests (this objective is presumed for healthcare establishments). In this sense, it will not be each and every public-private partnership that would fall within the scope of the definition of an organization governed by public law as a type of public procurement contracting authority.

There is considerable corruption risk not only in the non-transparent and unclear way of establishing public-private partnerships but also in the rather easy arrangements under the LPP which enable them to channel budget resources to suppliers of goods and services, while circumventing the public procurement regime. For example, the obligation to apply this law to the consumption of goods and services by these entities refers only to those in which the government holds over 50% of the PPP. It is enough for the government to be involved with 50% in order to award contracts without applying the respective public procurement procedures, regardless of the value of the contract. To put it in brief, if those in government wish to channel substantial public resources to a supplier or a contractor who is close to them, without applying the LPP, it is sufficient for them to establish a PPP with a third close company with not more than 50% state participation.

It is recommendable in the future to apply competitive procedures to the establishment of the major types of public-private partnerships. For this purpose, it would be necessary to amend at least the *Law on the Administration* and the *Law on Local Government and the Local Administration*, so that to make reference to the LPP and require its application in such cases. As regards substantive law, these amendments could envisage grounds for the entry of a given administration into PPP of commercial or entirely public nature.



## CONCLUSION

This study justified the urgent need for optimization of the economic and legal policies to restrict and counteract corruption in public procurement and their integration into a complete and effective system. Its point of departure is the legal framework of public procurement and its statutory and institutional prerequisites for the occurrence of the most common corrupt practices. From the perspective of anti-corruption efforts, the following are the four major elements of this legal framework:

- a) the types of public procurement procedures;
- b) their scope from the point of view of contracting authorities and thresholds;
- c) the legal remedies;
- d) the system of control and sanctions.

In accordance with the *acquis communautaire*, the existing *Law on Public Procurement* defines three main principles underlying the legal framework of public procurement: openness and transparency; free and fair competition and equal treatment; non-discrimination. They shape the overall frame for assessing the effectiveness of the public procurement regime. The issue is whether the existing regime provides maximum transparency, competition and equal treatment of public procurement suppliers and contractors. These are the benchmarks for the assessment of the corruption risk and for the identification of the most vulnerable aspects of the legal framework of public procurement.

Many experts in Bulgaria believe that there is nothing more to be desired from the legal framework of public procurement since it has been almost completely harmonized with the *acquis communautaire*. Firstly, such a conclusion should be accepted with some reservations. There still exist essential discrepancies, especially with regard to the regime of concessions and some procedures. But even if this were true, it would mean that the commitments to the European Commission have been fulfilled but not necessarily those to the Bulgarian society, particularly with regard to the reduction and prevention of corruption. The harmonization with the EU legislation is primarily intended to guarantee the free movement of goods, people, services and capital within the single market. However, these freedoms imply and require a corruption-free business environment. Therefore the transposition of the *acquis communautaire* into the national legislation provides the

groundwork on which to build and it is particularly relevant when it introduces higher standards than those envisaged in the domestic legislation.

Secondly, the harmonization of the public procurement legislation is not a one-off act; it is a dynamic process of reflecting the continuously changing market challenges in the national legislations. Therefore it is never the ultimate goal but it is rather a tool in the process. From the perspective of the accountability of the legislature to society for the establishment of regulatory and institutional barriers to corruption, the relevant question is not whether the legislation is fully harmonized with the *acquis* but whether it meets the objectives for which it has been developed, i.e. whether it meets the specific social needs and copes with the corruption risks in the country.

There are still many urgent questions related to the optimization of the legal framework of public procurement from the perspective of the anti-corruption agenda of the Bulgarian society and their answers will not come from abroad. These are the issues of the thresholds above which the law operates; the guarantees against corruption at the sectoral contracting authorities; the negotiation arrangements and their share of the Bulgarian public procurement market; the powers and responsibilities of controlling bodies; the effectiveness of administrative and penal sanctions; the involvement of business associations in public procurement procedures.

The starting point for the identification of a practical solution to these issues can be found in the three principles which have already been mentioned: transparency, competition and equal treatment. But they are hardly sufficient on their own. Equally important are two other principles related to economic efficiency which tend to be underestimated for the time being. **Firstly**, the awarding and implementation of public procurement contracts should be carried out at minimum costs for the public and private sector. **Secondly**, the legal framework should guarantee not only equal treatment of suppliers and contractors but also equal treatment of the contracting authorities in comparison to the other market participants. Both principles are important from the perspective of economic efficiency and the protection of the public interest. They guarantee that the public sector will not consume goods and services at prices higher than those in the private sector, i.e. they are necessary preconditions for maximizing public benefit through the supply of public goods at prices close to the market levels. The problem is that the last two principles do not always and everywhere imply solutions of the same type that is required by the first three principles. The challenge for the reform in this area is to strike a proper balance between the principles of transparency and equal treatment, on the one hand, and the principles of economic efficiency, on the other.

Economic efficiency is related mainly to competition but it also often implies greater freedom of consumer choice than even the most up-to-date, perfect legal framework. This conclusion becomes increasingly relevant with globalization, the development of the knowledge-based economy, e-society, new technologies and commercial practices. The changes for the last two decades have enhanced the role of partnership relations, trust and confidence, expertise, and the choice of suppliers/contractors. In other words, all other conditions being equal, the



conventional approach to the selection of the supplier of many goods and services is not the most efficient solution from the perspective of the public interest. An example to this effect is the advantage that EC Directives give to suppliers and contractors from the European Union which is hardly aimed at maximum economic benefit, i.e. to ensure that the public sector is on equal footing with the private sector in the selection of suppliers of goods and services.

The ambition to optimize the public procurement system to make sure that it does not lag behind the development of the market has brought about a lot of remodeling of the harmonized European legislation and the entry of many negotiation procedures. They inevitably enhance the discretionary powers of the contracting authorities and limit the operation of the principles of competition and sometimes also of transparency. In brief, they increase the risk of corruption in public procurement. The effect of raising the lower thresholds set out in the legislation is similar.

It is only understandable that the prevailing approach to the reduction and prevention of corruption in Bulgaria is the legislative one. In other words, economic efficiency is often neglected in order to close all real and perceived loopholes for abuse in the laws. These measures frequently fail to produce a greater effect than mere repair work of filling in gaps and imperfections in the legal framework – something which Bulgarian businesses are increasingly skeptical about. Moreover, the transposition of the European norms is only the beginning of the optimization of the legal framework. It is much more important and difficult to attain the European standards for their implementation. In this context, the enhanced quality of the legal framework does not end with the modernization of the law; it depends on its feasibility under the Bulgarian conditions. After the exhausting and often self-serving pre-accession marathon of harmonizing the national legislation with the *acquis communautaire* the confidence in the potential of the law is seriously eroded without the requisite reforms of the judiciary. It is generally recognized that the legal framework of public procurement in Bulgaria is almost fully harmonized with that of the European Union but corrupt practices become greater in scale, better streamlined, and less vulnerable. The number of skeptics is growing as to whether the law is capable of reducing corruption in the public procurement sphere. Bribery is very difficult to prove and, in many cases, there might be no procedural irregularities, i.e. the awarding of the public procurement contract to a pre-selected contractor might be formally lawful.

These constraints raise the issue of the other priorities of the anti-corruption policy in this sector. They are more or less external to the legal framework of public procurement but they are equally important for the attainment of a sustainable anti-corruption effect. They include the following:

- financial control and accountability in the public sector;
- the efficiency of the judiciary;
- administrative capacity and the codes of conduct;
- the financing of political parties;

- the regulation of lobbying and conflicts of interests;
- the regulation of public-private partnerships;
- the declaration of the property and income of senior officials, etc.

Besides, it becomes ever more imperative to increase the share of economic analysis in the efforts to reduce and prevent corruption. Economic policies are usually reduced to the so-called “positive anti-corruption incentives”, such as the increase of salaries or party subsidies. However, these positive incentives can rarely reach the size and motivation potential of bribery in public procurement. It is more important to consider all internal (mainly the LPP and RSPP) and external sources of corruption risk in public procurement in their entirety and interaction from the viewpoint of costs and benefits for society and the economy. This implies an economic impact assessment of the various alternatives which are the focal point of the public debate today. These are, for instance, the questions whether regulation should cover even the smallest procurement or below a certain level they should be left to the discretion of administrative staff with all the subsequent risks.

The competition among the suppliers of goods and services for the public sector certainly runs the risk of being restricted by the growing administrative discretionary powers in the selection process. But it could be restricted also where the administrative costs (i.e. the time and money that the company spends to take part in the tender) as excessively high as a percentage of the total price of the supply. If businesses have to allocate time and money to participate in tenders even for the smallest procurement contracts, then the participants would hardly be the most qualified ones. Their alternative costs for the sale of their products to the public sector will be higher than the sales costs on the free market. This means that the public sector will consume at prices that are higher than the market ones which does not comply with the public interest in achieving maximum economic efficiency.

The solution of the issue of the sectoral chambers of associations is not so straightforward as it seems to be in the public debate. Again, the point of departure should be the assessment of the extent to which they can really be better guarantors of free competition and public interests than the state. Each entrepreneur considers free competition as the most important condition to reach the customers and to purchase raw materials at beneficial prices. But does it mean that, once established on the market, the entrepreneur will not strive for maximum profit, i.e. for monopoly or oligopoly over the goods and services that he supplies? Can sectoral associations guarantee the broadest possible and equal access to public procurement? Provided that they represent only their members are there guarantees that their interests coincide with the public interest? Can sectoral associations really safeguard public interests better than civil servants given the fact that the latter are, after all, subject to greater civil control?

The question about the optimal balance between the procedure prescribed by law and the discretionary powers of the contracting authorities cannot have a single answer for all European countries and it can hardly be resolved by means of

harmonization of the legislation. Modern impact assessment techniques should be applied to the regulations, taking into account the specific national circumstances. In this case, they have to weigh the losses to society due to the additional corruption risk which depends also on the effectiveness of the administrative and judicial anti-corruption barriers, against the benefits derived from the greater freedom of the contracting authorities to negotiate the best terms and conditions. Pre-fixing and strictly following the parameters of the supply or service is not always feasible or beneficial on the market. Generally, the access to negotiation procedures, competitive dialogue and framework agreements calls for a certain level of efficiency of the risk management system and independence of internal and external control, courts and prosecution offices to provide these benefits to society by bringing contracting authorities in the public sector closer to normal market conditions.

There are many questions and they have not been answered either in theory or in international practice. Moreover, in the international context they are essential elements of the freedom of movement of goods, services and capital and of the anti-corruption efforts. New challenges emerge in the process of globalization, development of e-society and e-commerce. The identification of the optimal Bulgarian solutions is still an area in which politics is in debt to businesses.



## APPENDIX 1. LARGEST PUBLIC PROCUREMENT CONTRACTING AUTHORITIES IN TERMS OF AMOUNT OF THE SIGNED CONTRACTS (10/2004 – 06/2006)

### 2004

1	Republican Road Infrastructure Fund (former Roads Executive Agency)	52,227,072
2	Natioanl Electrical Company /NEC/	47,586,833
3	Bulgarian State Railways /BDZ/	22,278,637
4	Mines "Maritza Iztok" - Radnevo	19,942,572
5	State Agency "State Reserve and War-Time Stocks"	14,671,313
6	Ministry of Health /MH	14,046,849
7	TMaritsa - East 2 TPP	13,051,728
8	Military Medical Academy	12,766,691
9	Ministry of Transport /MT/	12,206,323
10	Communications and ICT Development Agency	8,334,896

### 2005

1	Natioanl Electrical Company /NEC/	7,917,898,045
2	Republican Road Infrastructure Fund (former Roads Executive Agency)	520,783,120
3	Sofia Municipality	236,068,966
4	Maritsa - East 2 TPP	177,022,991
5	Ministry of Health /MH/	133,352,262
6	Military Medical Academy	133,196,172
7	Mines "Maritza Iztok" - Radnevo	126,984,335
8	State Agency "State Reserve and War-Time Stocks"	123,067,658
9	Ministry of Education and Science /MES/	108,793,775
10	Bourgas Municipality	89,455,155

## 2006

1	Republican Road Infrastructure Fund (former Roads Executive Agency)	755,940,684
2	Maritsa - East 2 TPP	107,523,480
3	Port Infrastructure State Company 80,257,699	80,257,699
4	National Electrical Company /NEC/	65,048,368
5	NPP Kozloduy	63,462,248
6	Varna Municipality	59,571,154
7	Ministry of Education and Science /MES/	48,339,494
8	Sliven Municipality	37,490,931
9	Autotransport EAD	32,997,000
10	Mines "Maritza Iztok" - Radnevo	31,775,190

Source: Public Procurement Agency

## APPENDIX 2. MAJOR PUBLIC PROCUREMENT CONTRACTING AUTHORITIES IN THE ENERGY SECTOR (1 OCTOBER 2004 – 30 JUNE 2006)<sup>43</sup>

### Coal or other solid fuels

Batch No.	Name of the Contracting Authority	Number of Procedures	Number of Contracts	Total Value of Contracts (levs)
265	Marista-East Mines EAD, Radnevo	195	166	177,856,575
235	Bobov Dol Mines EAD	78	67	11,077,706
592	Zdravets Mine EAD (in liquidation), Dimitrovgrad	4	2	10,899,944
552	Causto-Gold AD, Kyustendil	8	25	5,302,896
758	Briquelle EAD, Gulubovo	6	5	3,796,559
836	Maritsa Basin Mine EOOD (in liquidation)	5	5	1,485,216
1082	Ivan Rusev Mine EOOD, Zhitusha (in liquidation)	1	1	750,332
681	Pernik Mines EAD (in liquidation)	1	1	84,037
682	Colosh-BD EOOD, Bobov Dol	1	0	0
323	Pirin Mine EAD, Simitli	3	0	0

<sup>43</sup> The available data cover the period 01.10.2004 - 30.06.2006



### Gas or heating

Batch No.	Name of the Contracting Authority	Number of Procedures	Number of Contracts	Total Value of Contracts (levs).
123	Varna TPP EAD, Ezerovo	77	82	54,403,886
428	Bulgargas EAD	134	144	38,757,136
217	Bobov Dol TPP	89	91	27,148,856
678	District Heating – Russe EAD	29	23	9,098,695
277	District Heating – Sofia AD	38	27	8,031,011
305	District Heating –Pernik EAD	15	28	7,626,402
129	District Heating –Plovdiv EAD	32	27	3,023,155
633	Sevlievogas-2000 AD, Sevlievo	2	2	1,846,521
967	Balkangas 2000 AD	1	1	125,950
1086	District Heating – Vratsa EAD	1	1	100,000
198	District Heating –Sliven EAD	14	1	61,200
1184	District Heating –Shumen EAD	1	1	33,578
375	District Heating –Pleven EAD	5	0	0
937	District Heating –Burgas EAD	2	0	0

### Oil and natural gas

Batch No.	Name of the Contracting Authority	Number of Procedures	Number of Contracts	Total Value of Contracts (levs).
926	LUKOIL Neftochim Burgas AD	6	4	14,230,677
1123	Prospecting and Extracting oil and gas AD, Sofia	5	5	8,230,840

## Electricity

Batch No.	Name of the Contracting Authority	Number of Procedures	Number of Contracts	Total Value of Contracts (levs).
26	National Electric Company (NEC) EAD	209	208	7,975,438,347
246	Maritsa-East 2 TPP EAD	300	377	297,598,200
353	Kozlodui NPP EAD	322	326	139,673,269
15	Maritsa-East 3 Energy Company (EC) AD	229	272	105,738,588
609	Electric Distribution – Gorna Oryahovitsa AD	36	58	38,633,244
26	NEC EAD – High Voltage Networks Enterprise (HVNE)	91	92	33,644,654
143	EVN Bulgaria Electric Distribution AD, Plovdiv (former name Electric Distribution Plovdiv AD)	42	41	27,298,039
922	EVN Bulgaria Electric Distribution – Plovdiv (former name Electric Distribution – Stara Zagora AD)	35	41	26,413,695
225	Electric Distribution – Varna EAD	42	39	23,252,723
695	Electric Distribution – Sofia City EAD, Electric Distribution – Sofia Region AD, Electric Distribution – Pleven AD	25	27	12,603,896
26	NEC EAD – Dams and Cascades Enterprise	11	9	3,328,695
26	NEC EAD – Trafoelectroinvest Enterprise	11	8	2,854,562
924	Electric Distribution – Pleven AD	4	13	2,679,472
542	Electric Distribution – Sofia City EAD	4	2	2,536,100
26	NEC EAD – Hydro Power Plants – Rila Group) Enterprise (Rila Group HPP)	12	11	1,653,512
155	Electric Distribution – Sofia Region AD	4	3	1,055,845
26	NEC EAD – Belene NPP Branch	4	2	480,020
992	Energo-pro Bulgaria AD	3	0	0
460	Maritsa 3 TPP AD, Dimitrovgrad	1	1	0
1066	Maritsa-East 2 TPP EAD, Maritsa-East 3 Energy Company AD, Briquelle EAD	1	0	0



## APPENDIX 3.

### WHO IS WHO ON THE BULGARIAN ENERGY MARKET?

#### FRONTIER

It was registered in Sofia in 1994 under the name Frontier 7 and it was subsequently renamed into Frontier. It is owned by Krassimir Georgiev, Edward Manoukian and Georgi Sotirov (through their company Metaconsult BG EOOD, renamed into Euronex in December 2006). The business interests of the company lie mainly in the energy sector: Maritsa-East site, supplies of nuclear fuel to Kozlodui NPP, Tsankov Kamuk HPP and the Lower Arda Cascade, Yadenitsa dam, and consultancy related to Belene NPP. Frontier was the consultant of Entergy and Enel in their transaction for the rehabilitation of Maritsa-East 3 TPP at the value of \$600 million. The owners of Frontier have taken over several hydro power plants: Bor, Iglika, Zdravets, Elenov Dol, Yassen, Slubeshka, Lilia, Kositsa. Frontier became known to the wider public in 2004 because of its participation with 49% in the mega-project Burgas Universal Terminal (BUT), where the majority shareholder of 51% is Technoexportstroy. The idea is to have BUT build and operate the infrastructure at the point of entry of the two oil pipelines from Burgas to Alexandroupolis in Greece and to Vlora in Albania. Initially, BUT was subscribed with 75 %, together with Bulgargas, in the Burgas-Alexandroupolis Oil Pipeline International Project Company (IPC). Later on, the ownership of IPC which holds the entry terminal of the oil pipeline in Burgas was distributed in 51:49 ratio between Russia and Bulgaria. The Russian share belongs to Transneft, Rosneft and Gasprom Neft, while the Bulgarian share is distributed equally (24.5% each) between Technoexportstroy and Bulgargas. Frontier was removed from participation at the point of entry of the oil pipeline.

Over the years, related to Frontier through their owners have been the following companies: DMC Interactive OOD (where Krassimir Georgiev is a partner); TT Multra Trading Team, Dusseldorf; Microprocessor Systems, Pravets; the companies in the 7M Group (currency exchange offices with the participation of Georgi Sotirov); 7M Insurance and Reinsurance Company; 7M Life; Fontier Finance AD – investment intermediary; Bulinvest Group; Demax Print; Easypack, etc.

The group has interests in real estate and tourism. Georgi Sotirov and Krassimir Georgiev jointly manage Bansko Property Partners, in the second version of which (Bansko Property Partners 2) Krassimir Georgiev was a partner of Tsetsa Stancheva, mother of the former Executive Director of the district heating company in Sofia Valentin Dimitrov until the middle of 2006.

The companies in the group have some points of intersection with other corporate groups in the energy sector. For instance, Krassimir Georgiev is a partner of Bogomil Manchev (Risk Engineering) in the company whose objects include TV and radio broadcasting equipment and conductor communications equipment. This is CMC, where 33% belong to Risk Engineering, 33 % to Frontier, and 33 % to Grozdan Dobrev.

The prosecution completed its investigation of Frontier in April 2007, which found out no violations, and ruled that there was no evidence of the commission of an offence.

## **RISK ENGINEERING**

It was considered to be the most influential corporate group in the energy sector over the period 1997 – 2005. Owner of 60 % of Risk Engineering is Bogomil Manchev who is a nuclear engineer. He is also a shareholder in the following companies: SCES (30 %), Fisk Consult (33 %), Perennia (50 %), Risk Engineering-D (6.806 %), Nova Soft Technology (17 %), Bulgarian Energy (50 %). He participates in the management of Risk Engineering, Ters Moshino, Risk Power, Risk Engineering-F, Risk Engineering-D, GCR, Risk Engineering AD, Transimpex, the Bulgagrian Nuclear Forum Association, and the Consortium for Sustainable Energy Development.

The group around Risk Engineering holds the largest percentage of the supplies of goods and services to the Bulgarian energy sector. The company features in the Public Procurement Register as the supplier of spare parts for thermal power plants, the contractor for the safety check of the nuclear units in Kozlodui NPP, consultant engineer (or architect engineer) of projects for the building, refurbishment and rehabilitation of power plants (e.g. Maritsa-East 2 TPP), etc. It has also implemented contracts beyond the scope of the LPP, hence outside the Public Procurement Register. Specially for the construction of Belene NPP Risk Engineering, in consortium with the European branch of the U.S. company parsons, has been appointed by NEC as the architect engineer of the project without any competitive procedure under the LPP due to its unique expertise in the sector. Their joint venture GCR OOD will be the supervisor of all construction works. The declared value of the service ranges between €300 million and €400 million, depending on the future contract with the contracting authority NEC and the contractor Atomstroyexport. Initial estimates point to €3.997 billion for the construction of Belence NPP according to the bid of the Russian company. This amount reaches €5 billion with the interest accrued on the loans or more than €6 billion with the construction of the infrastructure facilities on the site and the improvements of the electric system. The commitment of the Russian side is to have at least 30 % of the resources to be allocated to Bulgarian subcontractors. This means at least €1.2 billion in the form of contracts awarded to Bulgarian companies in the next eight years. It will cover five main areas: engineering services, construction works, assembly and installation works, supplies, and adjustment of the systems. The involvement of subcontractors like Glavbolgarstroy, Minstroy Holding, Enemona, Atomenergoremont and others has already been announced and the list is not final. No formal public procurement procedures are envisaged for the selection of subcontractors.

GCR OOD is owned by Risk Engineering (51 %) and the U.S. company Gilbert Commonwealth International (49 %) which was acquired by Parsons Engineers & Constructors in 1995. The company is registered at the address of Risk Engineering. Managers of GCR are Mogomil Manchev, Djurica Tankosic and the U.S. citizen

Robert Vaughn. The latter is vice-president of Parsons for business development in Europe, the former Soviet republics and Parsons Group International Limited.

### **PARSONS BULGARIA**

Parsons E & C Bulgaria is registered at the address of Risk Engineering. It is 100 % owned by the British company Parsons E & C Europe Limited and managed by Djurica Tankosic. Tankosic has experience in the nuclear power plants of former Yugoslavia (Slovenia and Serbia) and in the United States. He came to Bulgaria in 1994 and did the first feasibility study for the district heating company of Sofia. Parsons E & C Bulgaria is a consultant to Kozlodui NPP for the project concerning the modernization of units 5 and 6. The company is the engineer consultant for the rehabilitation of Maritsa-East 2 TPP (Risk Engineering is the subcontractor) and architect engineer of the Belene NPP project. Parsons E & C Bulgaria EOOD has recently been selected as a consultant to the project for the construction of Mohovce NPP.

At the end of 2004 it was officially announced that the control of Parsons E & C Europe Limited had been taken over by Worley Group Limited and hence it already operated under the name Worley Parsons. The subdivision of Worley Parsons in London is named WorleyParsons Europe Ltd. Its places of operation include the United Kingdom, as well as the former Soviet republics, the Middle East, South-East Asia and Australia. So far Parsons E & C Europe Ltd. Has been commissioned the feasibility study for the construction of Belene NPP and the environmental impact assessment at the value of \$7.7 million and the activities of an architect engineer (technical consultant) to NEC EAD for the same project at the value of €18.99 million per annum.

### **ATOMENERGOREMONT**

The company was established in 1974 for the repair and maintenance of the facilities at Kozlodui NPP. In 1978, it began to manufacture spare parts, units and equipment and to perform on-site repair of energy facilities, as well as to provide services and to perform construction works. In 2001, Atomenergoremont repair enterprise was transformed into a state-owned single-member shareholding company. On 27 October 2003, after the privatization procedure was completed, Atomenergoremont EAD was transformed into Atomenergoremont AD, where the major shareholder is the Bulgarian Energy Company EOOD owned by Hristo Kovachki. Atomenergoremont EAD carries out current repair works and overhaul at Kozlodui NPP and it is also involved directly in the reconstruction and modernization of the energy units of the nuclear power plant. It provides some repair services to Vidin TPP, Maritsa-East 2 TPP. The company manufactures and repairs spare parts, metal structures, heat exchangers, high-voltage engines, heat insulation and other equipment for Bulgarian and foreign companies.

Hristo Kovachki owns or controls several hydro power plants, the only briquette factory in Bulgaria – Briquell, the district heating company in Pleven, the tire processing factory in Gaber, and the Europa chain of stores. Kovachki himself

claims that he is only a consultant for most of the projects but he points out in interviews that he is the employer of over five thousand people. Companies from the group hold 26 % of the Municipal Bank AD and 20 % of the Municipal Insurance Company AD.

### **MINSTROY HOLDING – BULGARIAN ECO PROJECTS**

Minstroy Holding AD is a subcontractor in the Belene project. The main figure in the company is Nikolai Valkanov, former director of the Mining Research Institute and then director general of the state-owned company Minstroy Holding. Until October 2003 he was a member of the Managing Board of Multigroup and in 2005 he became a member of the managing board of Chimimport AD, Sofia. Some years ago, Minstroy Holding was a company through which Multigroup exercised control over more than 13 companies and was a minority shareholder in several others such as Balkanstory, United Energy Systems, Energy 94, Eurola, Ares Petrol, Geotechno Engineering, etc.

In 2004, Minstroy was taken over by Bulgarian Eco Projects which currently holds 86% of Minstroy Holding. Since April 2004 Minstroy has been the main contractor of the construction of Tsankov Kamuk hydro power facilities with the financial support of Alpine Meireder. According to the trade registers, the Austrian company holds 51 % of Alpine Bulgaria and the other 49 % belong to Bulgarian Eco Projects which, in turn, owns 86 % of Minstroy Holding. The Council of Ministers adopted Decision No. 592 of 2 September 2003 to select the National Electric Company as the contractor for the project. The financing includes an export loan of €100 million and a commercial loan of €120 million provided by Austrian and other European banks. In 2006, Minstroy Holding obtained a permit to prospect and to operate deposits of oil, coal and rock materials. The involvement of Minstroy Holding in the construction of Belene NPP was announced in October of the same year.



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Boyko Todorov  
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5 Alexander Zhendov Str. 1113 Sofia  
phone: (+359 2) 971 3000  
fax: (+359 2) 971 2233  
www.csd.bg  
csd@online.bg